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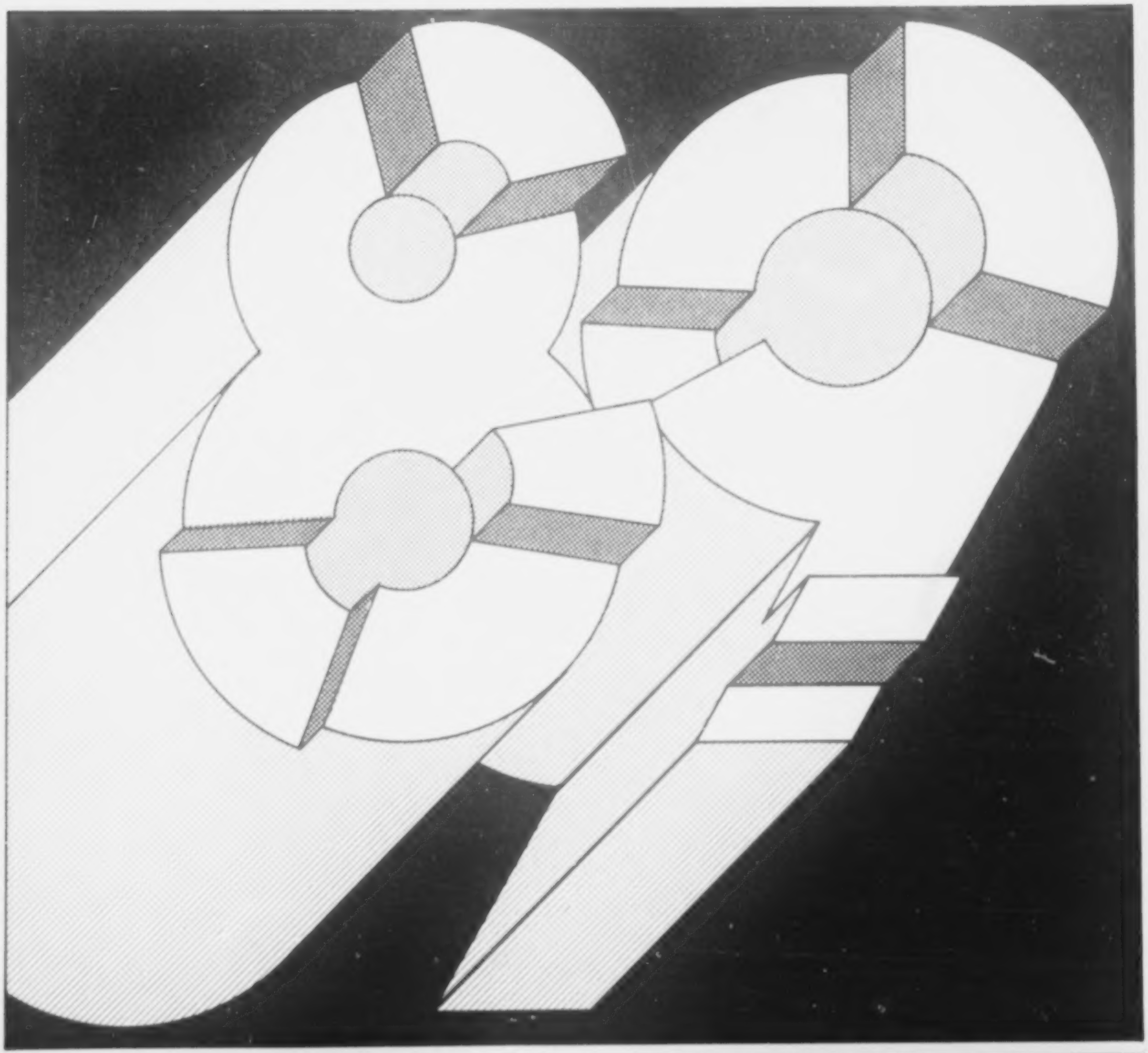
An Analysis of the President's Budgetary Proposals for Fiscal Year 1989

Prepared at the Request of the
Senate Committee on Appropriations



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AN ANALYSIS OF THE PRESIDENT'S BUDGETARY PROPOSALS FOR FISCAL YEAR 1989

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NOTES

Unless otherwise indicated, all years referred to in this report are fiscal years.

Dashes in tables indicate amounts less than $50 million.

Details in the text and tables of this report may not add to totals because of rounding.

The source of data concerning the President's budget is the Office of Management and Budget. The source of other data, unless otherwise noted, is the Congressional Budget Office.

To facilitate comparison with the CBO baseline, allowances for the President's proposed civilian pay raises in 1990 through 1993 have been distributed among the individual budget functions, and the effects of the Administration's proposals for credit reform have been excluded.

The Balanced Budget and Emergency Deficit Control Act of 1985 is referred to in this volume more briefly as the Balanced Budget Act. The Balanced Budget and Emergency Deficit Control Reaffirmation Act of 1987 is referred to more briefly as the Balanced Budget Reaffirmation Act.

PREFACE

This analysis of the President's budget for fiscal year 1989 was prepared at the request of the Senate Committee on Appropriations. The report discusses the President's policy proposals in terms of changes from the Congressional Budget Office (CBO) baseline budget projections for 1989 through 1993. It provides estimates of the budgetary impact of the Administration's proposals using CBO's economic assumptions and technical estimating methods.

This report was prepared by the staffs of the Budget Analysis, Fiscal Analysis, and Tax Analysis Divisions under the supervision of James L. Blum, Jacob S. Dreyer, and Rosemary D. Marcuss, respectively. Paul N. Van de Water was responsible for Chapter I; John Sabelhaus for Chapter II; Rosemary D. Marcuss for Chapter III; Michael A. Miller for Chapter IV; Charles E. Seagrave and Robert A. Sunshine for Chapter V; and Kathy A. Ruffing for Appendix A. Principal contributors are listed in Appendix B.

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Acting Director

March 1988

CONTENTS

I SUMMARY AND INTRODUCTION 1

CBO Budget Estimates *3*
The Administration's Budget Program *7*

II A COMPARISON OF ECONOMIC ASSUMPTIONS 13

The Short-Run Outlook *13*
Medium-Term Projections *16*

III THE ADMINISTRATION'S REVENUE PROPOSALS 21

CBO Reestimates *21*
Revenue Proposals *26*

IV THE ADMINISTRATION'S DEFENSE BUDGET 33

Defense Funding Levels *33*
CBO Reestimates *35*
Major Defense Proposals *39*

V THE ADMINISTRATION'S NONDEFENSE BUDGET 59

Human Resources Programs *59*
Natural Resources, Infrastructure, and Other Government Services *62*
Other Nondefense Spending *64*
Details by Budget Function *65*

150 International Affairs *66*
250 General Science, Space, and Technology *70*
270 Energy *72*
300 Natural Resources and Environment *76*
350 Agriculture *80*
370 Commerce and Housing Credit *83*
400 Transportation *88*
450 Community and Regional Development *91*
500 Education, Training, Employment, and Social Services *95*
550 Health *99*
570 Medicare *102*
600 Income Security *108*
650 Social Security *115*
700 Veterans Benefits and Services *117*
750 Administration of Justice *120*
800 General Government *123*
900 Net Interest *125*
920 Allowances *127*
950 Undistributed Offsetting Receipts *129*

APPENDIXES

A Baseline Budget Projections 135

B Major Contributors to the Revenue and Spending Estimates 139

TABLES

I-1	CBO and Administration Estimates of the Administration's Budget Program	4
I-2	Effects of CBO Economic Assumptions on Estimates of the Administration's Deficit	5
I-3	CBO Reestimates Resulting from Different Technical Assumptions	6
I-4	The Administration's Deficit Reduction Program as Estimated by CBO	7
I-5	CBO Estimates of the Administration's Budget Program	10
II-1	Comparison of Administration, CBO, and Blue Chip Short-Run Economic Forecasts	15
II-2	Comparison of Administration and CBO Economic Assumptions, 1988-1993	17
III-1	Administration and CBO Estimates of Administration Revenues, by Major Source	22
III-2	CBO Reestimates of Administration Budget Revenues	23
III-3	Revenue Proposals in the Administration's 1989 Budget	27
IV-1	Major Spending Proposed in Administration's 1989 Budget for Function 050: National Defense	34
IV-2	Major Spending Changes Proposed in Administration's 1989 Budget for Function 050: National Defense	36

IV-3	Annual Real Growth in Defense Spending Authority	37
IV-4	Reestimates of the President's 1989 Request for Function 050: National Defense	39
IV-5	Summary of Active Forces	41
IV-6	Requested Strength Levels for Military Personnel	42
IV-7	Nominal Changes in Operation and Maintenance	45
IV-8	Nominal Changes in Procurement	48
IV-9	Program Terminations in the Administration's 1989 Budget	49
IV-10	Selected Program Changes in the 1989 Request for Aircraft Procurement	51
IV-11	Selected Program Changes in the 1989 Request for Other Missiles, Torpedoes, and Weapons Procurement	53
IV-12	Nominal Changes in Research, Development, Test, and Evaluation	55
V-1	CBO Estimates of the Administration's Proposals in Nondefense Spending (In billions of dollars)	60
V-2	CBO Estimates of the Administration's Proposals in Nondefense Spending (In percentage differences from the CBO baseline)	61
A-1	CBO Baseline Budget Projections	136

A-2 Revisions to the CBO Baseline Since February 1988 137

FIGURES

I-1 Federal Deficit Projections and Targets 2

II-1 Comparison of Administration, CBO, and Blue Chip Economic Assumptions 19

BOXES

I-1 Social Security in the Budget 9

V-1 The Budget Summit and Differences in CBO and Administration Estimates 103

CHAPTER I

SUMMARY AND INTRODUCTION

The Congressional Budget Office (CBO) estimates that the federal deficit under Administration policies would be $165 billion in 1989, $157 billion in 1990, and $109 billion in 1993. These figures are considerably higher than the Administration's own estimates--$130 billion in 1989, $104 billion in 1990, and $23 billion in 1993. Most of the differences between the CBO and Administration estimates reflect assumptions about the future of the economy. CBO foresees less rapid real growth, higher inflation, and higher interest rates than does the Administration.

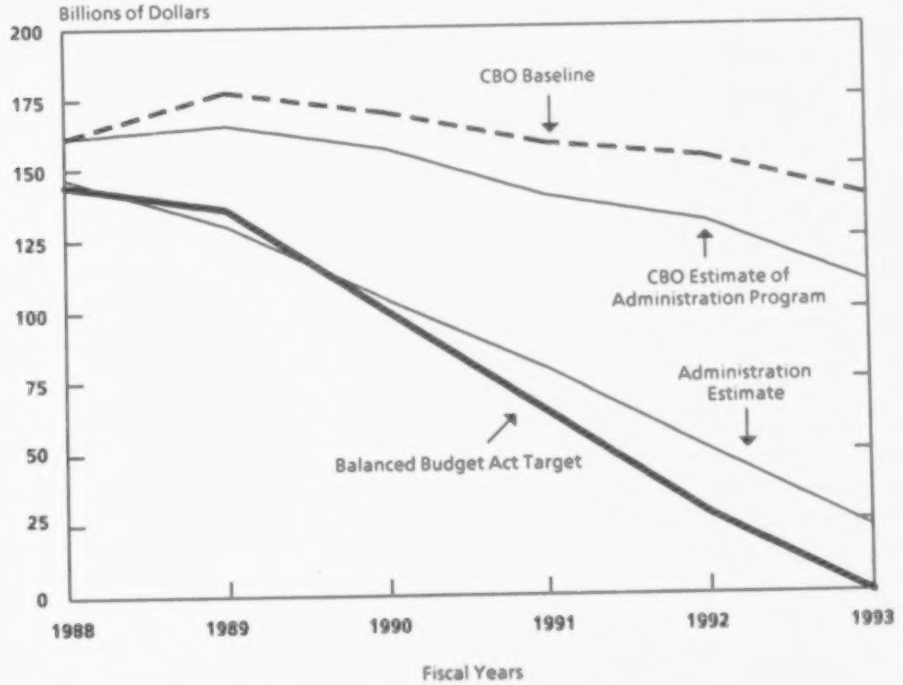
The Administration's 1989 deficit estimate of $130 billion appears to fall below the statutory target of $136 billion. But excluding $10 billion in asset sales, which may not be counted as savings under the terms of the Balanced Budget Reaffirmation Act, the Administration's estimate would be $140 billion. The budget also exceeds the deficit targets in 1990 through 1993 under both CBO and Administration assumptions, as shown in Figure I-1.

CBO analyzes the Administration's budget in terms of changes from the CBO baseline, which projects the course of the budget on the assumption that current taxing and spending policies continue unchanged. CBO reestimates, or reprices, the Administration's budget using CBO's economic and technical estimating assumptions and methods. The differences between the baseline projections and the CBO estimate of the budget measure the effects of the Administration's proposed policy changes. CBO estimates that the Administration's proposals would reduce the deficit by $12 billion in 1989, $13 billion in 1990, and $29 billion in 1993.

CBO's baseline budget deficits rise from $150 billion in 1987 to $161 billion in 1988 and $177 billion in 1989, before dropping to $170 billion in 1990. These baseline projections update those published last month in CBO's annual report, *The Economic and Budget Outlook: Fiscal Years 1989-1993*. The revisions are described in Appendix A.

As in past years, the baseline budget projections assume that revenues, offsetting receipts, and entitlement spending are projected according to the laws now on the statute books. Defense and nondefense discretionary appropriations are assumed to be held constant in real terms. This year, CBO has made minor changes in its baseline to make it identical to the budget base specified in the Balanced Budget Reaffirmation Act.

Figure I-1.
Federal Deficit Projections and Targets



SOURCE: Congressional Budget Office; Office of Management and Budget.

NOTE: Totals include Social Security, which is off-budget (see Box I-1 on page 9).

CBO BUDGET ESTIMATES

CBO's estimates of the deficit exceed the Administration's figures by $15 billion in 1988, $36 billion in 1989, and increasing amounts in later years. In 1989, $25 billion of the $36 billion in reestimates is attributable to differing economic assumptions, and $11 billion stems from technical estimating differences. In 1991 through 1993, virtually all of the reestimates are economic (see Table I-1).

Effects of Economic Assumptions

CBO and Administration economic assumptions are compared in Chapter II. CBO's assumptions of lower real economic growth and higher interest rates tend to increase the estimated deficits, while its assumption of higher inflation tends to lower them, as shown in Table I-2. Lower real economic growth holds down tax receipts, while raising outlays for Unemployment Insurance and related programs. CBO's real growth assumption adds to the deficit in the President's budget by amounts growing from $7 billion in 1988 to $12 billion in 1989 and $67 billion in 1993. Higher interest rates raise debt service costs by $2 billion in 1988, $13 billion in 1989, and $52 billion in 1993.

Differences in inflation assumptions have little effect on the deficit estimates for the first few years, but CBO's higher inflation rates reduce the estimated deficits by $7 billion in 1991, $17 billion in 1992, and $33 billion in 1993. In the long run, faster inflation increases most revenue sources (by increasing taxable incomes and consumption) but raises only some outlay categories (primarily indexed benefit programs, Medicare, and Medicaid). CBO bases its estimates of defense and nondefense discretionary appropriations on the dollar amount of the Administration's request; it does not increase the request to take account of CBO's higher assumed inflation rates. If CBO's assumptions about inflation prove correct, these appropriations will buy fewer real goods and services than the Administration currently anticipates.

TABLE I-1. CBO AND ADMINISTRATION ESTIMATES OF THE ADMINISTRATION'S BUDGET PROGRAM
(By fiscal year, in billions of dollars)

	1988	1989	1990	1991	1992	1993
Estimates						
Revenues						
Administration	909	965	1,044	1,124	1,190	1,258
CBO	899	955	1,038	1,113	1,182	1,262
Outlays						
Administration	1,056	1,094	1,148	1,204	1,241	1,281
CBO	1,060	1,120	1,195	1,253	1,313	1,371
Deficit						
Administration	147	130	104	79	51	23
CBO	161	165	157	140	131	109
Differences in Estimates						
Revenues						
Technical	-3	-2	2	-1	a/	2
Economic	-7	-8	-8	-11	-9	2
Total	-10	-10	-6	-12	-8	4
Outlays						
Technical	1	9	14	1	6	1
Economic	3	17	33	48	66	88
Total	4	26	46	49	72	90
Deficit						
Technical	4	11	12	2	5	a/
Economic	10	25	41	59	75	86
Total	15	36	53	61	80	86

SOURCE: Congressional Budget Office; Office of Management and Budget.

NOTE: Totals include Social Security, which is off-budget.

a. Less than $500 million.

Effects of Technical Assumptions

Technical reestimates increase the estimated 1989 deficit by $11 billion, comprising $2 billion in lower revenues and $9 billion in higher outlays (see Table I-3). Of the outlay differences, only a small portion involves discretionary accounts. Roughly $0.5 billion is in national defense programs, and slightly less than $0.5 billion is in nondefense discretionary appropriations. The nondefense discretionary differences are small because the Administration generally elected to use CBO estimates for these accounts. CBO's 1989 outlay estimates for deposit insurance, Medicare, and income security programs are each $2 billion higher than the Administration's. Finally, CBO expects a total of $4 billion in lower proceeds from asset sales and loan prepayments.

Many of the same technical factors that increase the 1989 deficit also add to outlays in 1990. In addition, CBO believes that the first

TABLE I-2. EFFECTS OF CBO ECONOMIC ASSUMPTIONS ON ESTIMATES OF THE ADMINISTRATION'S DEFICIT (By fiscal year, in billions of dollars)

	1988	1989	1990	1991	1992	1993
Lower Real Economic Growth	7	12	20	34	51	67
Higher Interest Rates	2	13	23	32	41	52
Higher Inflation a/	1	b/	-2	-7	-17	-33
Total Economic Reestimates	10	25	41	59	75	86

SOURCE: Congressional Budget Office.

NOTE: The figures include the changes in debt service costs caused by different borrowing.

a. Any effect of inflation on interest rates is included in the previous line.

b. Less than $0.5 billion.

auction for drilling rights in the Arctic National Wildlife Refuge (ANWR) could not occur before 1991; the Administration assumes that, if the Congress acts this year, leasing could begin in 1990. By increasing the deficit, the technical reestimates also increase interest costs by $2 billion in 1990. After 1990, technical reestimates are small in total.

TABLE I-3. CBO REESTIMATES RESULTING FROM DIFFERENT TECHNICAL ASSUMPTIONS (By fiscal year, in billions of dollars)

	1988	1989	1990	1991	1992	1993
Revenues	-3	-2	2	-1	a/	2
Outlays						
National defense	2	1	a/	1	a/	-1
Nondefense discretionary appropriations	-1	a/	-3	-2	a/	1
Arctic National Wildlife Refuge leasing	--	--	2	-2	1	-1
Farm price supports	-1	a/	a/	-1	-2	-2
Deposit insurance	-1	2	1	a/	a/	-1
Postal Service	a/	a/	1	-3	-1	-3
Medicare	1	2	2	2	1	a/
Income security	a/	2	3	4	3	5
Net interest	2	a/	2	1	2	1
Asset sales and prepayments	-1	4	3	a/	a/	a/
Other	a/	a/	-1	a/	2	1
Total Outlays	1	9	14	1	6	1
Total Technical Reestimates	4	11	12	2	5	a/

SOURCE: Congressional Budget Office.

a. Less than $0.5 billion.

THE ADMINISTRATION'S BUDGET PROGRAM

CBO's baseline projections provide a benchmark against which the Administration's budget program can be measured. Because the baseline and the CBO estimate of the budget employ the same economic and technical assumptions, differences between the two are solely the result of proposed policy changes. The Administration's budget would cut the projected deficits only modestly. CBO estimates that the Administration's budget proposals would reduce the 1989 deficit to $165 billion--$12 billion below the baseline level of $177 billion. The amount of deficit reduction grows to $13 billion in 1990, $19 billion in 1991, and $29 billion in 1993, as shown in Table I-4.

TABLE I-4. THE ADMINISTRATION'S DEFICIT REDUCTION PROGRAM AS ESTIMATED BY CBO
(By fiscal year, in billions of dollars)

	1989	1990	1991	1992	1993
CBO Baseline Deficit	177	170	159	154	139
Policy Changes					
Revenues a/	-1	-1	-1	-1	-1
National Defense	-1	b/	1	3	5
Nondefense Discretionary Spending	-2	-2	-8	-12	-16
Entitlements and Other Mandatory Spending	-3	-6	-6	-6	-6
Offsetting Receipts	1	b/	-4	-4	-6
Asset Sales and Prepayments	-6	-3	b/	b/	b/
Net Interest	b/	-1	-2	-4	-5
Total Policy Changes	-12	-13	-19	-23	-29
Deficit, President's Budget as Estimated by CBO	165	157	140	131	109

SOURCE: Congressional Budget Office.

a. Revenue increases are shown with a negative sign because they reduce the deficit.

b. Less than $0.5 billion.

The Administration's revenue proposals would reduce the deficit by about $1 billion per year. Additional revenues would be generated by requiring all state and local government employees to pay the Medicare tax and by repealing the scheduled reduction in airport and airway tax rates. Proposals for more favorable tax treatment of research and experimentation spending, mutual fund expenses, and higher education savings bonds would reduce revenues.

For defense and nondefense discretionary spending, the Administration budget is guided by the appropriation caps contained in the Omnibus Budget Reconciliation Act of 1987 (Public Law 100-203). The CBO baseline projections do not reflect the 1989 savings from these caps, because these savings are not yet enacted. Instead, the baseline assumes 1989 appropriations based on the 1988 amounts adjusted for inflation of roughly 4 percent. The caps, in contrast, allow increases in budget authority of only 2.5 percent for defense and 2.0 percent for nondefense programs. By adhering to the appropriation caps, the Administration budget reduces defense outlays by $1 billion and nondefense discretionary spending by $2 billion in 1989 compared with the baseline.

After 1989, defense budget authority in the Administration's request would grow by 1 percent per year in real terms, based on CBO economic assumptions. The Administration claims a higher rate of real defense growth because of its lower inflation rate. CBO estimates that defense outlays would be close to the baseline amount in 1990 and would exceed the baseline by $1 billion in 1991 and $5 billion in 1993. Nondefense discretionary savings would remain at about $2 billion in 1990 and would grow to $8 billion in 1991 and $16 billion in 1993.

The Administration proposes few changes in entitlement and other mandatory programs. Entitlement reductions total $3 billion in 1989 and $6 billion per year thereafter. About a third of the reductions would be in Medicare, where the Administration proposes to lower reimbursement to health care providers. Reductions are also proposed in Guaranteed Student Loans, Medicaid, and rehabilitation services. The Administration proposes no changes in Social Security benefits (see Box I-1).

BOX I-1
SOCIAL SECURITY IN THE BUDGET

CBO's analysis of the 1989 budget focuses on total revenues, outlays, and the deficit. The totals include the activities of the Old-Age, Survivors, and Disability Insurance (OASDI) trust funds, which were taken off-budget by the Balanced Budget Act of 1985. The Balanced Budget Act nevertheless requires that the total deficit be used when calculating required deficit reductions. The total deficit also determines the federal government's borrowing needs.

CBO's estimates of on- and off-budget revenues, outlays, and the deficit under the Administration's budgetary proposals are shown below. The projected decline in the total deficit from $161 billion in 1988 to $109 billion in 1993 stems entirely from growing surpluses in Social Security. The on-budget deficit remains near $200 billion every year. The Administration is proposing no changes in Social Security benefits or taxes.

	1987 Actual	1988 Base	Projections				
			1989	1990	1991	1992	1993
On-Budget							
Revenues	641	658	696	754	806	854	909
Outlays	811	857	907	970	1,016	1,067	1,116
Deficit	170	199	211	216	210	212	207
Off-Budget (Social Security)							
Revenues	213	240	259	283	307	327	353
Outlays	194	203	213	225	237	246	255
Surplus	20	38	46	58	70	81	98
Total							
Revenues	854	899	955	1,038	1,113	1,182	1,262
Outlays	1,005	1,060	1,120	1,195	1,253	1,313	1,371
Deficit	150	161	165	157	140	131	109

SOURCE: Congressional Budget Office.

TABLE I-5. CBO ESTIMATES OF THE ADMINISTRATION'S BUDGET PROGRAM (By fiscal year)

	1988	1989	1990	1991	1992	1993
			In Billions of Dollars			
Revenues						
Individual income	390	414	454	493	532	573
Corporate income	98	106	117	124	128	132
Social insurance	331	354	383	410	435	467
Other	79	81	84	85	87	90
Total	899	955	1,038	1,113	1,182	1,262
Outlays						
National defense	287	295	306	321	335	351
Nondefense discretionary spending	176	191	201	198	204	206
Entitlements and other mandatory spending	501	532	567	605	644	688
Net interest	152	166	184	196	200	203
Offsetting receipts	-56	-58	-61	-67	-70	-76
Additional asset sales	a/	-6	-3	a/	a/	a/
Total	1,060	1,120	1,195	1,253	1,313	1,371
Deficit	161	165	157	140	131	109
Debt Held by the Public	2,046	2,211	2,367	2,504	2,634	2,743
			As a Percent of GNP			
Revenues						
Individual income	8.3	8.3	8.5	8.7	8.7	8.8
Corporate income	2.1	2.1	2.2	2.2	2.1	2.0
Social insurance	7.1	7.1	7.2	7.2	7.2	7.2
Other	1.7	1.6	1.6	1.5	1.4	1.4
Total	19.2	19.2	19.5	19.6	19.4	19.4
Outlays						
National defense	6.1	5.9	5.8	5.6	5.5	5.4
Nondefense discretionary spending	3.8	3.8	3.8	3.5	3.3	3.2
Entitlements and other mandatory spending	10.7	10.7	10.7	10.6	10.6	10.6
Net interest	3.2	3.3	3.4	3.4	3.3	3.1
Offsetting receipts	-1.2	-1.2	-1.2	-1.2	-1.2	-1.2
Additional asset sales	b/	-0.1	-0.1	b/	b/	b/
Total	22.7	22.5	22.4	22.0	21.6	21.1
Deficit	3.4	3.3	2.9	2.5	2.2	1.7
Debt Held by the Public	43.7	44.4	44.4	44.0	43.3	42.2

SOURCE: Congressional Budget Office.

NOTE: Totals include Social Security, which is off-budget.

a. Less than $0.5 billion.

b. Less than 0.05 percent of GNP.

Proposed changes in offsetting receipts would increase outlays by $1 billion in 1989, have little net effect in 1990, and reduce outlays by $4 billion in 1991 and $6 billion in 1993. The 1989 increase results primarily from a proposal to reclassify certain customs user fees as revenues rather than as offsetting receipts. Additional receipts would be garnered over the five-year period through raising beneficiary premiums for Supplementary Medical Insurance (Part B of Medicare), increasing Postal Service payments for employee retirement, and leasing rights to drill for oil in the Arctic National Wildlife Refuge.

Asset sales account for $6 billion, or half, of the 1989 deficit reduction. Slightly more than $3 billion derives from the prepayment or sale of loans made by the Rural Electrification Administration and other agencies. Sale of the Naval Petroleum Reserves and the Alaska Power Marketing Administration would yield somewhat less than $3 billion. Proposed asset sales contribute $3 billion to deficit reduction in 1990 and little thereafter.

Chapters III, IV, and V describe the Administration's revenue, defense, and nondefense spending proposals--as well as CBO's reestimates--in more detail. If enacted, these proposals would have only a small effect on the composition of revenues and outlays. Table I-5 on the preceding page shows CBO's estimates of the Administration's budget program by major tax source and spending category. The numbers differ little from the CBO baseline projections, which are shown in Appendix A.

CHAPTER II

A COMPARISON OF ECONOMIC ASSUMPTIONS

Economic assumptions play an important role in budget estimates. For example, estimates of future tax receipts depend on assumptions about the growth of the economy. Estimates of federal outlays depend on assumptions about unemployment, inflation, and other factors. Assumptions about interest rates have become increasingly key, since the cost of servicing the federal debt now makes up a large part of total expenditures.

The importance of economic assumptions was dramatized in 1987, when turbulence in financial markets raised concern about the short-term strength of the U.S. economy. Rising interest rates in late spring, and the October stock market crash, led forecasters to revise their projected GNP growth rates downward. Other economic assumptions important in forecasting the budget deficit were also reexamined, including the future paths of interest rates, inflation, and unemployment.

Moreover, the turbulence in financial markets led to a sharp divergence of views among forecasters about the future course of the economy. Since the stock market crash, forecasters have become more pessimistic on average.

THE SHORT-RUN OUTLOOK

After last October, both CBO and the Administration revised downward their estimates of near-term GNP growth, as did most private forecasters. CBO projects 1.8 percent real growth in 1988, and the Administration 2.4 percent, as compared with the 3.8 percent real growth experienced in 1987 (see Table II-1). CBO expects very slow growth in the first part of 1988, followed by more rapid growth later in the year. This pattern is close to the average of forecasts in the *Blue Chip* survey of forecasts. 1/ The Administration expects the economy to grow at a more consistent rate of 2.0 percent to 2.5 percent throughout the year. The slow growth in the first half of 1988 projected by both CBO and the *Blue Chip* consensus is just above the 1.0 percent rate below which the Balanced Budget Act allows budget sequestration to be set aside.

In 1989, most forecasters see an upturn in the economy. CBO expects GNP to grow by 2.6 percent, somewhat less than the Administration forecast of 3.5 percent, but above the *Blue Chip* consensus of 2.2 percent. CBO's economic forecasts and projections are described in detail in its publication, *The Economic and Budget Outlook: Fiscal Years 1989-1993* (February 1988).

Growth Factors

CBO and the Administration have similar views about the composition of real growth in 1988. Improvement in the real trade balance--that is, real net exports--is projected to be the largest contributor to economic growth in 1988. Over half of the growth in the Administration forecast is projected to come from that source, and even more in the CBO forecast. CBO and the Administration also agree that inventory accumulation will not contribute to growth as it has for the last few years. Consumer spending fell sharply in real terms in the fourth quarter of 1987. Both CBO and the Administration expect real consumer spending to grow between the fourth quarter of 1987 and the fourth quarter of 1988, but not at the rapid pace experienced in recent years (until the fourth quarter of 1987). In its forecast for fixed investment, the Administration is more optimistic than CBO. The Administration also sees less of a slowdown in real government purchases.

---

1. Eggert Economic Enterprises, Inc., *Blue Chip Economic Indicators* (March 10, 1988).

TABLE II-1. COMPARISON OF ADMINISTRATION, CBO, AND BLUE CHIP SHORT-RUN ECONOMIC FORECASTS (By calendar year)

	Actual	Forecast	
	1987	1988	1989
Fourth Quarter to Fourth Quarter (Percent change)			
Real GNP			
Administration	3.8	2.4	3.5
CBO	3.8	1.8	2.6
Blue Chip	3.8	1.8	2.2
Nominal GNP			
Administration	7.2	6.4	7.3
CBO	7.2	5.7	6.9
Blue Chip	7.2	5.5	6.7
Consumer Price Index a/			
Administration	4.5	4.3	3.9
CBO	4.5	4.9	4.8
Blue Chip	4.5	4.1	4.7
Calendar Year Averages (Percent)			
Three-Month Treasury Bill Rate			
Administration	5.8	5.3	5.2
CBO	5.8	6.2	6.7
Blue Chip	5.8	5.9	6.4
Ten-Year Government Note Rate			
Administration	8.4	8.0	7.4
CBO	8.4	9.3	9.5
Blue Chip b/	8.4	8.8	9.0
Civilian Unemployment Rate			
Administration c/	6.1	5.8	5.6
CBO	6.2	6.2	6.1
Blue Chip	6.2	6.0	6.1

SOURCE: Congressional Budget Office; Office of Management and Budget; Eggert Economic Enterprises, Inc., *Blue Chip Economic Indicators* (March 10, 1988). The CBO forecast is based on preliminary 1987 fourth-quarter data published in January 1988; the February revisions were small and are not included.

a. Consumer Price Index for urban wage earners and clerical workers.

b. *Blue Chip* does not project a 10-year note rate. The values shown here are based on the *Blue Chip* projection of the AAA bond rate, adjusted by CBO to reflect the estimated spread between AAA bonds and 10-year government notes.

c. The Administration's projection is for the total labor force, including armed forces residing in the United States, while the CBO and *Blue Chip* projections are for the civilian labor force excluding armed forces. In recent years, the unemployment rate for the former has tended to be 0.1 to 0.2 percentage points below the rate for the civilian labor force alone.

Inflation

The forecasts differ significantly with respect to inflation. CBO expects inflation to increase slightly in the near term, from the 4.5 percent increase in the Consumer Price Index (CPI) observed in 1987 to 4.9 percent in 1988, while the Administration and the *Blue Chip* consensus expect inflation to come down slightly in 1988, to 4.3 percent and 4.1 percent, respectively. In 1989, the *Blue Chip* forecasters expect the economy to pick up, and inflation to rise along with it to 4.7 percent. The Administration, on the other hand, expects inflation to continue downward in 1989, to 3.9 percent. CBO expects inflation to remain at 4.8 percent in 1989, reflecting the assumption that the fall in the dollar will generate higher import and consumer prices.

Interest Rates

CBO expects three-month Treasury bill rates to rise from 5.8 percent in 1987 to 6.2 percent in 1988, and 6.7 percent in 1989. The *Blue Chip* agrees with the direction of the movement, but its consensus levels for 1988 and 1989 are 30 basis points below CBO's projection. The Administration sees three-month Treasury bill yields falling to 5.3 percent in 1988, and 5.2 percent in 1989. CBO projects long-term interest rates 130 basis points above the Administration's forecast in 1988, and 210 basis points higher in 1989. In large part, this difference reflects the Administration's view that inflation rates will fall in 1987 and beyond, and that the improvement will be reflected in investors' long-term expectations.

MEDIUM-TERM PROJECTIONS

Neither CBO nor the Administration attempts to forecast the economy beyond the end of 1989. In making their projections for the period 1990 through 1993 (shown in Table II-2), both organizations rely on historical experience.

TABLE II-2. COMPARISON OF ADMINISTRATION AND CBO ECONOMIC ASSUMPTIONS, 1988-1993 (By calendar year)

Economic Variable	Actual 1987	1988	1989	1990	1991	1992	1993
Nominal GNP (Billions of dollars)							
Administration	4,486	4,779	5,113	5,481	5,850	6,207	6,548
CBO	4,486	4,744	5,068	5,414	5,782	6,179	6,606
Real GNP (Percent change, year over year)							
Administration	2.9	2.9	3.1	3.5	3.4	3.3	3.2
CBO	2.9	2.3	2.6	2.6	2.6	2.7	2.7
Consumer Price Index a/ (Percent change, year over year)							
Administration	3.6	4.3	4.1	3.6	3.2	2.7	2.2
CBO	3.6	4.5	4.9	4.6	4.4	4.4	4.4
GNP Deflator (Percent change, year over year)							
Administration	3.0	3.5	3.8	3.6	3.2	2.7	2.2
CBO	3.0	3.4	4.1	4.1	4.1	4.1	4.1
Three-Month Treasury Bill Rate (Percent)							
Administration	5.8	5.3	5.2	5.0	4.5	4.0	3.5
CBO	5.8	6.2	6.7	6.6	6.4	6.1	5.9
Ten-Year Government Note Rate (Percent)							
Administration	8.4	8.0	7.4	6.8	6.0	5.0	4.5
CBO	8.4	9.3	9.5	9.0	8.4	7.8	7.4
Civilian Unemployment Rate (Percent)							
Administration b/	6.1	5.8	5.6	5.4	5.3	5.2	5.2
CBO	6.2	6.2	6.1	6.0	5.9	5.9	5.8
Tax Bases							
Wage and salary disbursements							
Administration	2,213	2,344	2,502	2,676	2,858	3,040	3,212
CBO	2,213	2,344	2,512	2,690	2,876	3,075	3,289
Other personal income c/							
Administration	1,533	1,634	1,743	1,845	1,948	2,041	2,131
CBO	1,533	1,623	1,739	1,857	1,981	2,113	2,251
Corporate Profits d/							
Administration	273	310	353	406	448	471	492
CBO	273	281	327	358	379	392	408

SOURCES: Congressional Budget Office; Office of Management and Budget.

a. Consumer Price Index for urban wage and clerical workers.

b. The Administration's projection is for the total labor force, including armed forces residing in the United States, while the CBO projection is for the civilian labor force excluding armed forces. In recent years, the unemployment rate for the former has tended to be 0.1 to 0.2 percentage points below the rate for the civilian labor force alone.

c. Other personal income is personal income less wage and salary disbursements.

d. Corporate profits reported are book, not economic, profits.

CBO's Method

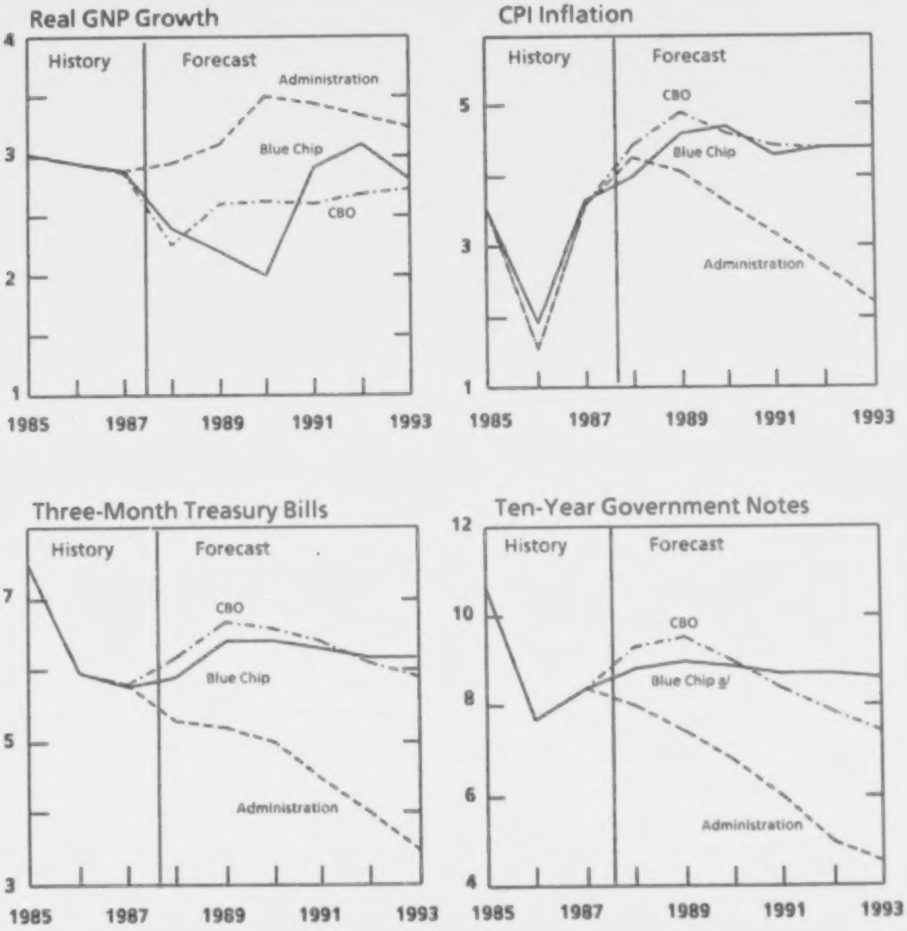
CBO bases its medium-term projections of GNP on projections of gross domestic product (GDP), which differs from GNP by excluding the net income earned by U.S. residents on overseas assets. Using information on labor market trends, CBO calculates a path for GDP growth estimated to be consistent with nonaccelerating inflation. The levels of GDP on this path are referred to as "potential" GDP. In the CBO forecast, actual GDP is specified to approach the potential level over the medium term. Since the potential growth rate of GDP for the next five years is about 2.5 percent per year, actual GDP growth is projected to be stronger than 2.5, so as to close the gap between actual and potential. Because U.S. net international indebtedness is likely to rise for some years to come, the flow of net income from assets overseas is expected to decline. Hence, the growth of GNP should trail slightly behind the growth in GDP over the medium term (1990 through 1993), averaging 2.6 percent to 2.7 percent.

Comparison of Projections

The Administration's medium-term projections are based on long-term trends and on its views of the implications of its policy proposals. The Administration projects stronger real GNP growth after 1989, at rates of 3.2 percent to 3.5 percent per year, which are from one-half to one percentage point higher than the CBO projections, and 0.2 to 1.5 percentage points above the consensus (see Figure II-1). The Administration's projections for levels of nominal GNP are slightly above CBO's for most of the medium term, but never more than 2 percent higher. The CBO projections for nominal GNP approach those of the Administration, and by 1993 the CBO nominal GNP level is higher.

As in the short-run outlook, the Administration projects lower inflation than does CBO after 1989: both CPI inflation and the rate of change in the GNP deflator rise slightly in 1988 and 1989, then fall steadily to rates of 2.2 percent per year in 1993. CBO assumes a constant inflation rate of 4.1 percent after 1989, close to the historical average of 4.3 percent since 1950, though a little below CBO's short-term forecast for the end of 1989 (see Figure II-1).

Figure II-1.
Comparison of Administration, CBO, and Blue Chip Economic Assumptions



SOURCE: Congressional Budget Office; Office of Management and Budget; Eggert Economic Enterprises, Inc., *Blue Chip Economic Indicators* (March 10, 1988).

a. *Blue Chip* does not project a ten-year note rate. The values shown here are based on the *Blue Chip* projection of the AAA bond rate, adjusted by CBO to reflect the estimated spread between AAA bonds and ten-year government notes.

The Administration and CBO both project lower interest rates by the end of 1993. As shown in Figure II-1, the Administration's interest-rate projections for 1989 through 1993 start at lower levels and decrease faster than the CBO projections. By the end of 1993, the Administration projects the 10-year government bond rate to be at 4.5 percent, while CBO projects the rate at 7.4 percent. These patterns are consistent with expectations about future inflation. Both CBO and the *Blue Chip* consensus expect higher inflation than the Administration, and this is reflected in higher interest rates.

The Tax Base

The differences between the Administration's and CBO's economic assumptions are reflected in their projections of the tax base from which federal revenues are drawn. In the CBO forecast, as economic growth slows, the share of GNP going to wage and salary disbursements rises, consistent with historical experience. Real wages outpace productivity gains through 1993, and therefore wage and salary disbursements remain relatively high--above the Administration's projection. Corporate profits in the CBO projection are lower than in the Administration's, partly because of higher interest rates and partly because of the higher share of income going to wages.

CHAPTER III

THE ADMINISTRATION'S REVENUE PROPOSALS

Using its own economic assumptions and estimation procedures, the Congressional Budget Office projects that the President's budget program would result in revenues of $955 billion in 1989 and $1,038 billion in 1990. Budget revenues are projected to increase at an average rate of 6.7 percent per year over the 1991-1993 period, reaching $1,262 billion in 1993. They are projected to grow from 19.2 percent of GNP in 1989 to 19.4 percent in 1993, the same shares projected by the Administration (see Table III-1). The CBO estimates are $10 billion lower than the Administration estimate for 1989 and $6 billion lower for 1990. New revenue proposals are of small budget significance: proposed tax increases and the reclassification of customs user fees as revenues are offset for the most part by proposed tax reductions. The proposals add $0.5 billion to revenues in 1989, $1.3 billion in 1991, and $0.6 billion in 1993.

The proposals discussed in this chapter involve taxes and fees that are classified as revenues in the unified budget. Other user fee proposals are discussed in Chapter V.

CBO REESTIMATES

Roughly 90 percent of the difference between CBO's and the Administration's budget revenue estimates is directly attributable to different assumptions about the economy. In each year through 1992, the effects of CBO's lower real growth assumption prevail, resulting in revenue estimates that are lower than the Administration's. In 1993, CBO's higher inflation assumption results in higher CBO revenue estimates for that year. Other assumptions are sometimes referred to as technical, and mostly concern the behavior of government agencies and trust funds and the reaction of taxpayers to changing tax law. These assumptions hold down CBO's revenue projections relative to

TABLE III-1. ADMINISTRATION AND CBO ESTIMATES OF ADMINISTRATION REVENUES, BY MAJOR SOURCE
(By fiscal year, in billions of dollars)

Revenue Source	1988	1989	1990	1991	1992	1993
Administration Estimates						
Individual Income Taxes	393.4	412.4	448.9	490.5	524.4	557.5
Corporate Income Taxes	105.6	117.7	129.3	140.6	148.8	153.8
Social Insurance Taxes and Contributions						
On-budget	91.6	96.1	100.1	104.0	108.1	113.4
Off-budget a/	239.9	258.5	282.4	306.0	324.9	346.7
Excise Taxes	35.3	35.2	36.1	34.7	34.1	34.7
Other	43.3	44.8	47.2	48.7	49.6	51.9
Total Revenues	909.2	964.7	1,044.1	1,124.4	1,189.9	1,258.1
Percent of GNP	19.3	19.2	19.3	19.5	19.4	19.4
CBO Estimates						
Individual Income Taxes	390.1	414.5	453.6	493.0	531.5	572.9
Corporate Income Taxes	98.2	105.5	117.2	124.0	127.6	131.8
Social Insurance Taxes and Contributions						
On-budget	90.9	95.1	99.4	103.5	108.0	114.1
Off-budget a/	240.3	259.0	283.2	306.8	327.4	353.0
Excise Taxes	34.3	34.1	34.8	33.4	32.7	33.2
Other	45.0	46.6	49.3	51.9	54.4	56.8
Total Revenues	898.8	954.8	1,037.6	1,112.7	1,181.6	1,261.9
Percent of GNP	19.2	19.2	19.5	19.6	19.4	19.4

SOURCE: Office of Management and Budget, *Budget of the United States Government for Fiscal Year 1989* (February 1988), and Congressional Budget Office revenue estimates.

a. Off-budget revenues consist of those from federal Old-Age, Survivors, and Disability Insurance (OASDI) trust funds.

Administration estimates in 1988, 1989, and 1991 by small amounts and raise CBO's revenue projections in 1990, 1992, and 1993 (see Table III-2).

Differences in Economic Assumptions

Compared with the Administration's economic assumptions, CBO's assumptions are characterized by slower economic growth and higher inflation and interest rates. CBO's projections for nominal GNP are lower than the Administration's through 1992. By 1993, the cumulative effects of higher inflation outweigh those of the slower output growth, putting CBO's nominal GNP above the Administration estimate for the year. (The two sets of economic assumptions are compared in more detail in Chapter II.)

TABLE III-2. CBO REESTIMATES OF ADMINISTRATION BUDGET REVENUES (By fiscal year, in billions of dollars)

	1988	1989	1990	1991	1992	1993
Revenues as Estimated by the Administration a/	909.2	964.7	1,044.1	1,124.4	1,189.9	1,258.1
CBO Reestimates						
Economic	-7.4	-8.0	-8.3	-10.7	-8.7	2.1
Other	-3.0	-1.9	1.8	-1.0	0.4	1.7
Total	-10.4	-9.9	-6.5	-11.8	-8.3	3.8
Revenues as Estimated by CBO a/	898.8	954.8	1,037.6	1,112.7	1,181.6	1,261.9

SOURCE: Office of Management and Budget, *Budget of the United States Government for Fiscal Year 1989* (February 1988), and Congressional Budget Office revenue estimates.

a. Revenues include payroll tax receipts of the federal Old-Age, Survivors, and Disability Insurance (OASDI) trust funds, which are off-budget.

The largest discrepancy in tax bases occurs in corporate profits. The slowdown in growth projected by CBO produces flat profits in 1988, leaving them well below Administration estimates in 1989. CBO expects the profit share of GNP to be lower in 1988 and 1989 than assumed by the Administration, and this difference widens over the projection period. CBO's projected taxable profits are almost 10 percent below the Administration estimate in 1989 and close to 20 percent below by 1993. These differences reduce corporate income taxes in the CBO estimate by $8 billion in 1989 and more than $20 billion in 1993. The slower economic growth and higher interest rates projected by CBO also reduce capital gains, a component of the individual income tax base excluded from the National Income and Product Accounts. As a result, CBO revenue estimates are lower by several billion dollars per year.

Other significant differences between the CBO and Administration tax bases tend to increase the CBO revenue estimate relative to the Administration estimate. CBO projects higher wage and salary income than does the Administration, despite its lower nominal GNP path through 1992. This raises income and payroll tax revenues above Administration estimates by increasing amounts over the period. Higher projected imports raise CBO estimates of customs duties above the Administration's by $350 million in 1989, $600 million in 1990, and more than $1 billion each year from 1991 through 1993. CBO's higher interest rates boost projected Federal Reserve System profits above the Administration level, adding almost $2 billion to CBO revenues in 1989 and almost $6 billion in 1993.

Differences in Other Assumptions

Other assumptions have a relatively minor effect on the CBO estimate of the President's budget. They place CBO revenues $1.9 billion below the Administration estimate in 1989, $0.3 billion of which results from a deficit-neutral reclassification of customs user fees as revenues by the Administration. These assumptions result in budget revenue reestimates of $2 billion or less per year after 1989, adding to the CBO reestimate in three years and reducing it in one year (see Table III-2).

The largest difference in the estimate of 1989 revenues resulting from an alternative assumption about a trust fund, rather than from the economic assumptions discussed above, is CBO's assumption of lower target balances in the combined federal-state Unemployment Insurance system. CBO projects trust fund balances in accordance with guidelines suggested by the General Accounting Office in 1987 and projects state tax rates that will achieve these balances. The Administration projects balances above the suggested range, requiring higher tax rates. The lower rates projected by CBO result in revenues $1.3 billion lower than Administration revenues in 1989. By 1993, the difference between the two revenue estimates is $2.6 billion.

In 1989, different assumptions about the revenue effects of provisions of recent legislation, in particular the Tax Reform Act of 1986, increase CBO individual income tax revenues and lower corporate income taxes relative to Administration estimates. Taken together, these differences raise CBO income tax estimates $0.5 billion above Administration estimates in 1989. After 1989, CBO's estimates of greater revenue gains from individual provisions that broaden the income tax base are the cause of larger positive income tax reestimates through 1993.

Another assumption with a significant effect on the revenue estimates, especially after 1990, is that the Federal Reserve System's average yield on its holdings of Treasury securities is more responsive to changes in interest rates over time, regardless of the level of interest rates. CBO projects that a greater share of the Federal Reserve System's portfolio will mature after 1990 and will be replaced by securities with lower yields. This assumption holds CBO's revenue estimate below the Administration's by only a small amount in 1989, $1 billion in 1991, and about $2 billion in 1993.

In most cases, CBO's reestimates of the effect of the President's proposals on revenues were minor. The one exception is the reestimate of the President's proposal to delay future pay increases for federal employees by three months and adjust the rates each year. This proposal is discussed in Chapter V. CBO assumes that the adjustment will have no effect on revenues, an assumption CBO employs for proposals to adjust the compensation of only one subgroup within the labor force at large. The Administration, on the other hand, assumes that the pay adjustment will reduce income and payroll tax revenues by about $1 billion per year beginning in 1990.

REVENUE PROPOSALS

CBO estimates that the President's revenue proposals would add small amounts of revenue, raising tax receipts by $0.5 billion in 1989, $1.3 billion in 1991, and $0.6 billion in 1993 (see Table III-3). This estimate differs only slightly from the Administration's. It is roughly $150 million lower than the Administration estimate in 1989, slightly higher in 1990 through 1992, and slightly lower in 1993. CBO has higher revenue estimates for 1990 through 1992 because it does not share the Administration's view that the proposed federal pay cap will have a negative effect on revenues. For Administration proposals other than the federal pay cap, CBO estimates a slightly smaller increase in revenues than does the Administration.

The President proposes to establish a permanent research and experimentation (R&E) credit, change R&E allocation rules for tax purposes, establish a permanent exemption for mutual fund shareholder expenses, initiate higher education savings bonds, establish a credit to shareholders for taxes paid on U.S. source income by foreign corporations, modify oil and gas depletion rules, and change the basis of a customs user fee. CBO estimates that these proposals will reduce revenues by $1.7 billion in 1989 and $13.9 billion over the 1988-1993 period.

The President proposes to offset these revenue reductions by requiring Medicare contributions from all state and local government employees, repealing the scheduled reduction in airport and airway tax rates, and initiating or extending fees. CBO estimates that these provisions will raise revenues by $1.5 billion in 1989 and by $16.8 billion over the 1988-1993 period.

In addition, the Administration proposes to reclassify the customs user fee enacted in the Omnibus Budget Reconciliation Act of 1986 as a revenue rather than an offsetting collection on the outlay side of the

TABLE III-3. REVENUE PROPOSALS IN THE ADMINISTRATION'S 1989 BUDGET (By fiscal year, in billions of dollars)

	1988	1989	1990	1991	1992	1993	Cumulative 1988-1993 Changes
CBO Baseline Revenues	898.5	954.2	1,036.4	1,111.4	1,180.6	1,261.3	
Proposed Changes							
Establish permanent R&E credit	n.a.	-0.4	-0.8	-1.0	-1.2	-1.4	-4.8
Change R&E allocation rules	-0.4	-0.6	-0.7	-0.7	-0.8	-0.9	-4.1
Establish permanent mutual fund shareholder expense exclusion	0	-0.4	-0.5	-0.6	-0.7	-0.9	-3.1
Initiate higher education savings bonds a/	n.a.	b/	-0.1	-0.2	-0.3	-0.4	-1.0
Repeal windfall profit tax	0	0	0	0	0	0	0
Require Medicare contributions of all state and local employees c/	n.a.	1.5	1.9	1.9	2.0	2.0	9.2
Repeal reduction in airport and airway taxes d/	n.a.	n.a.	0.9	1.6	1.8	1.9	6.1
Reclassify customs user fee as a revenue	0.7	0.8	0.8	e/	n.a.	n.a.	2.4
Change basis and extend customs user fee d/	n.a.	-0.2	-0.2	0.4	0.4	0.4	0.7
Other	n.a.	-0.1	b/	-0.1	-0.1	-0.2	-0.4
Total	0.3	0.5	1.3	1.3	1.0	0.6	4.9
President's Budget Revenues as Estimated by CBO	898.8	954.8	1,037.6	1,112.7	1,181.6	1,261.9	

SOURCE: Congressional Budget Office revenue estimates.

NOTE: n.a. = not applicable.

a. Proposal would reduce outlays, producing a net deficit increase ranging from $7 million in 1989 to $128 million in 1993.

b. Revenue decrease of less than $50 million.

c. Proposal would increase outlays by about $45 million over the 1989-1993 period.

d. Net of income and payroll tax effects.

e. Revenue increase of less than $50 million.

budget. This proposal will add to tax receipts but will have no effect on the deficit. The President also proposes to repeal the windfall profit tax, which CBO expects will have no effect on revenues. CBO estimates that the proposals will add a total of $4.9 billion to receipts from 1988 through 1993, only $0.1 billion higher than the Administration estimate. When outlay effects of the proposals are included, CBO estimates that the proposals will increase the deficit by $0.2 billion in 1989, but that their overall effect will be to reduce the deficit by $3.2 billion over the 1988-1993 period.

Research and Experimentation Credit

The President proposes to make permanent the tax credit for research expenditures that is scheduled to expire at the end of 1988. The proposed credit rate and qualified expenditures are the same as under current law. The credit allows businesses to reduce their tax liability by 20 percent of the amount by which current research expenses exceed average expenditures over the preceding three years: the credit therefore covers increasing research expenditures only. Legislation extending the credit was introduced in the Senate and the House last session, but no action was taken. Both CBO and the Administration estimate that the proposal will reduce tax receipts by $0.4 billion in 1989 and by $4.8 billion from 1989 through 1993.

Research and Experimentation Allocation Rules

Spending on research and experimentation not only is eligible for the tax credit but also can be deducted from current income like other business expenses. The President proposes to alter the rules governing allocation of research expenses between domestic and foreign source income. The proposal is to increase the minimum share of expenses undertaken in the United States that can be allocated to U.S. source income for tax purposes from 30 percent to 67 percent. (The Tax Reform Act of 1986 had allowed a temporary 50 percent minimum allocation, but that provision has expired.) The change in the allocation rule converts domestic source income into foreign source income. Because the foreign tax credit can be used only to offset the U.S. tax on foreign source income, the conversion would allow additional foreign tax credits to be used to reduce U.S. tax payments on world-wide income. A similar provision passed the House last year in the reconciliation bill but was dropped in conference. Both CBO and the Administration estimate that the proposal will reduce tax receipts by $0.6 billion in 1989 and by $4.1 billion over the 1988-1993 period.

Mutual Fund Shareholder Expense Exclusion

The Tax Reform Act of 1986 required that certain fees charged to the shareholder in a publicly traded mutual fund be included in the gross income of the shareholder. The Omnibus Budget Reconciliation Act of 1987 delayed the effective date of this provision until 1988. The President proposes to repeal the provision. If the provision were to remain in effect, these expenses would be includable in miscellaneous expenses for tax purposes. Miscellaneous expenses are deductible, however, only to the extent that they exceed 2 percent of adjusted gross income. Both CBO and the Administration estimate that repeal would reduce tax receipts by $0.4 billion in 1989 and by $3.1 billion over the 1988-1993 period.

Higher Education Savings Bonds

The President proposes to allow the interest on U.S. savings bonds to be tax exempt if the proceeds of the bond are used to pay certain college and vocational school costs. At present, taxation of the interest on these bonds is deferred until redemption. Eligibility for the tax exemption would be phased out for higher-income taxpayers, based on their income at the time the bond is redeemed. Similar legislation was introduced in the Senate last session. CBO estimates the revenue reduction to be about $20 million in 1989, rising to $0.4 billion in 1993, and totaling $1.0 billion from 1989 through 1993. The Administration estimates a revenue reduction of $0.5 billion over the five-year period. Partial substitution of these bonds for other government bonds will reduce federal government interest payments. CBO estimates that revenue reduction will exceed outlay reduction, producing a $0.3 billion increase in the deficit in 1989 through 1993.

Repeal of Windfall Profit Tax

The President proposes repeal of the crude oil windfall profit tax, which is currently scheduled to be phased out by the end of 1993. Little or no liability for the windfall profit tax was incurred last year, following the significant drop in oil prices in 1986. CBO estimates that no future liability will be incurred through 1993, based on current oil price projections. Repeal would therefore have no effect on revenues. The Administration estimates that repeal would reduce total revenues by $87 million over the 1988-1993 period, based on its higher projected oil prices. CBO agrees that repeal of the windfall profit tax would reduce future receipts if prevailing oil prices prove to be higher than those now projected by CBO. The Senate version of the Omnibus Trade and Competitiveness Act of 1987, which is now in conference, includes a provision repealing the tax.

World oil prices are subject to influences that make once-and-for-all resolution of future price movements impossible. Oil market developments may lead market specialists and other informed observers to revise their oil price projections upward from current levels. CBO's future baseline estimates for the windfall profit tax will reflect the changing market conditions. Therefore, CBO may project positive windfall profit tax liabilities in a future budget baseline; in fact, positive liabilities for 1988 through 1992 were projected by CBO as recently as August 1987.

State and Local Government Employee Medicare Contributions

As he did last year, the President proposes that one-quarter of state and local government employees--those hired before April 1, 1986--and their employers not now contributing to the Hospital Insurance (HI) portion of the Medicare system be required to do so. The majority of the employees not contributing are nonetheless eligible for Medicare benefits through spouses' employment or other jobs held outside state and local government. CBO estimates that, under the proposal, payroll taxes would increase by $1.5 billion in 1989 and $9.2 billion over the 1989-1993 period. These estimates are about $0.2 billion per year lower than the Administration estimates. Benefits would be boosted by about $45 million over the same period, according to CBO estimates. The bulk of the increase in benefits flowing from the extension of coverage would occur in later years.

A similar proposal was introduced in the Senate in the last two sessions of the Congress in the form of amendments to the Omnibus Budget Reconciliation Acts of 1986 and 1987, but the provisions were dropped before passage. State and local government employees hired after March 31, 1986, are not affected by the proposal because they were covered under HI in the Consolidated Budget Reconciliation Act of 1985.

Repeal of Scheduled Reduction in Airport and Airway Tax Rates

The President proposes that airport and airway tax rates be extended at current rates through 1993 to prevent reduction in these rates by one-half in 1990 as projected under current tax law. The Airport and Airway Improvement Amendments of 1987 extended aviation taxes at current rates through 1989 and specified that most of the rates would be halved on January 1, 1990, if obligations for airport grants-in-aid and appropriations for Federal Aviation Administration facilities, equipment, and research in 1988 and 1989 have not averaged 85 percent of their authorized amounts. CBO and the Administration project that appropriated and obligated amounts will fall short of the threshold, triggering the reduction in rates. CBO estimates that extension of the taxes at current rates will increase airport and airway taxes by $6.1 billion over the 1990-1993 period, an amount which is almost the same as the Administration estimate.

Customs User Fee Adjustments

The President proposes to reclassify the ad valorem customs user fee enacted in the Omnibus Budget Reconciliation Act of 1986 as a revenue rather than an offset in an expenditure account. CBO estimates that this would move $0.8 billion in receipts to the revenue side of the budget in 1989 and $2.4 billion in 1988 through 1991. The fee is scheduled to expire at the end of 1990. This accounting change would be deficit neutral.

The President also proposes to extend the fee through 1993 and change its basis, beginning in 1989, from the value of the imported good to the cost of customs processing. This adjustment is proposed as a requirement for compliance with the General Agreement on Tariffs and Trade. CBO estimates that these two changes, taken together, will reduce customs duties receipts by $0.2 billion in 1989 and $0.3 billion in 1990. After 1990, extension of the fee adds $0.5 billion to customs duties per year through 1993. The net revenue effect, after income and payroll tax offsets, is a revenue reduction of $0.2 billion per year in 1989 and 1990 and a revenue increase of $0.4 billion per year beginning in 1991.

Other

The President proposes to initiate marine fishing license fees and a fee for Federal Emergency Management Agency regulation of nuclear power plants, and to increase the share of Nuclear Regulatory Commission (NRC) costs recovered through user fees. (The President's budget treats the NRC fee receipts as revenues. CBO counts them as offsetting collections on the outlay side of the budget in accordance with language enacted as part of the continuing resolution for 1988 appropriations, Public Law 100-202.) The President also proposes to establish a credit to shareholders for taxes paid on U.S. source income by foreign corporations, modify oil and gas depletion rules, and for the sixth year, to increase the District of Columbia government contributions to the Civil Service Retirement System. The CBO baseline assumes extension of Leaking Underground Storage Tank and Vaccine Injury Compensation trust fund taxes at current rates through 1993, but the President's budget does not contain comparable assumptions. Expiration of these taxes would reduce revenues slightly in 1990 through 1993. CBO estimates that these other proposals and adjustments will decrease tax receipts by $0.4 billion over the 1988-1993 period.

CHAPTER IV

THE ADMINISTRATION'S DEFENSE BUDGET

The President's budget for fiscal year 1989 proposes $299.5 billion in budget authority for the national defense function, the amount agreed to in the budget summit (see Table IV-1). The Administration's estimate for 1989 defense outlays is $294.0 billion, which also equals the level specified in the budget summit agreement.

The proposed budget authority level for 1989 is $33 billion below the level requested last year in the Administration's biennial request, and $8 billion below CBO's baseline projection. Compared with 1988 appropriations, it represents an increase of $8 billion or 2.8 percent, which is less than projected inflation. After 1989, however, the Administration proposes increases in budget authority that would slightly exceed the projected rate of inflation.

The proposed defense budget includes some force reductions from those planned a year ago, as well as a variety of stretch-outs, cancellations, and accelerations in the development and procurement of major weapons systems. A $1 billion increase is proposed for the Strategic Defense Initiative (SDI), which remains a high priority in the Administration's budget.

DEFENSE FUNDING LEVELS

For the last several years, the total defense budget has been discussed in real terms; that is, the debate has focused on how the budget changes after adjustments for inflation are made. These changes can be seen most clearly by comparing the President's budget with the CBO baseline.

The CBO baseline projects that defense funding will grow by no more and no less than the amounts necessary to cover inflation each

TABLE IV-1. MAJOR SPENDING PROPOSED IN ADMINISTRATION'S 1989 BUDGET FOR FUNCTION 050: NATIONAL DEFENSE (By fiscal year, in billions of dollars)

Account	1988	1989	1990	1991	1992	1993
Budget Authority						
Military Personnel	76.1	78.4	80.1	80.7	80.9	81.0
Operation and Maintenance	80.7	85.6	89.2	92.8	96.4	100.1
Procurement	81.0	80.0	85.3	91.1	98.0	105.6
RDT&E a/	36.7	38.2	40.0	42.0	44.0	45.9
Military Construction	5.4	5.7	6.0	6.3	6.6	6.9
Other-DoD	3.3	2.8	6.7	11.4	16.1	20.8
Subtotal-DoD	283.2	290.8	307.3	324.3	342.0	360.3
Other Defense	8.3	8.7	9.1	9.4	9.6	9.9
Administration's 1989 Budget as Reestimated by CBO	291.4	299.5	316.4	333.7	351.6	370.2
Outlays						
Military Personnel	75.3	78.3	80.1	80.7	80.8	81.0
Operation and Maintenance	80.0	83.1	86.9	90.5	94.0	97.6
Procurement	80.9	80.7	81.3	84.7	88.3	92.6
RDT&E a/	33.7	35.6	37.3	39.1	41.0	42.8
Military Construction	5.4	5.1	5.5	5.7	6.0	6.4
Other-DoD	4.0	3.3	6.5	11.0	15.7	20.4
Subtotal-DoD	279.3	286.0	297.5	311.7	326.0	340.8
Other Defense	8.1	8.5	8.9	9.2	9.5	9.8
Administration's 1989 Budget as Reestimated by CBO	287.5	294.5	306.4	321.0	335.5	350.6

SOURCE: Compiled by Congressional Budget Office based on data supplied by the Office of Management and Budget.

a. Research, development, test, and evaluation.

year during the 1989-1993 period. The budget exceeds the baseline by $1.6 billion over the five-year period, because the Administration's request would more than make up for real decline in 1989 by growth in the out-years (see Table IV-2). Based on CBO's economic assumptions, defense budget authority in the Administration's proposal would decline by 2 percent in real terms in 1989, but would grow by an average of about 1 percent in each of the following years through 1993. (This is a somewhat lower rate of real growth than the Administration claims because CBO projects a higher inflation rate over the 1989-1993 period. See Chapter II of this report.)

Even though 1989 is the fourth consecutive year of real decline in the defense budget, the request for 1989 is still 40 percent higher than actual budget authority for 1980. Table IV-3 illustrates the pattern of real growth from 1981 to 1989 in the appropriation categories used by the Congress. Annual funding has been steadiest for military personnel; operation and maintenance (O&M); and research, development, test, and evaluation (RDT&E). Funding for procurement, military construction, family housing, and other accounts has been much more variable. Real spending authority for these accounts has grown by 17 percent or more a third of the time, but it has fallen with equal frequency.

In the out-years, real growth would be more evenly distributed in the Administration's budget proposals. Again, procurement funding is an exception; between 1990 and 1993 it averages about 3 percent annual real growth, while all other accounts average about 1 percent.

CBO REESTIMATES

The purpose of CBO reestimates is to provide a technical appraisal of the budgetary impact of Administration policies. For some programs, this can include a reestimate of both budget authority and outlays. For defense programs, however, it usually involves only outlays. The Congressional Budget Office does not usually reestimate budget authority, since defense spending is viewed as discretionary and since the total amount of budget authority requested is as much a matter of policy as are the constituent programs.

TABLE IV-2. MAJOR SPENDING CHANGES PROPOSED IN ADMINISTRATION'S 1989 BUDGET FOR FUNCTION 050: NATIONAL DEFENSE (By fiscal year, in billions of dollars)

Changes	1989	1990	1991	1992	1993	Cumulative Five-Year Changes
			Budget Authority			
CBO Baseline	307.5	320.4	333.4	347.2	361.4	
Proposed Changes						
Military personnel	-0.9	0.1	0.7	0.7	0.5	1.2
Operation and maintenance	1.1	1.8	2.7	3.5	4.3	13.5
Procurement	-7.4	-5.8	-3.6	-0.5	3.2	-14.0
RDT&E a/	-0.4	-0.1	0.4	0.6	0.9	1.3
Military construction	--	0.1	0.2	0.2	0.2	0.8
Other-DoD	-0.6	-0.2	-0.2	-0.1	-0.1	-1.3
Subtotal	-8.1	-4.2	0.3	4.5	9.0	1.5
Other Defense	0.1	0.2	--	-0.1	-0.2	0.1
Total Changes	-8.0	-4.0	0.3	4.4	8.8	1.6
Administration's 1989 Budget as Reestimated by CBO	299.5	316.4	333.7	351.6	370.2	
			Outlays			
CBO Baseline	295.4	306.3	319.6	332.6	345.7	
Proposed Changes						
Military personnel	-0.9	--	0.6	0.7	0.5	0.9
Operation and maintenance	0.8	1.6	2.4	3.3	4.0	12.1
Procurement	-0.3	-1.2	-1.8	-1.5	-0.3	-5.1
RDT&E a/	-0.2	-0.2	0.1	0.5	0.7	0.9
Military construction	--	0.1	0.1	0.2	0.3	0.8
Other-DoD	-0.3	-0.3	-0.3	-0.2	-0.1	-1.2
Subtotal	-0.9	--	1.3	2.9	5.0	8.3
Other Defense	0.1	0.1	0.1	--	-0.2	--
Total Changes	-0.8	0.1	1.4	2.9	4.8	8.4
Administration's 1989 Budget as Reestimated by CBO	294.5	306.4	321.0	335.5	350.6	

SOURCE: Compiled by Congressional Budget Office based on data supplied by the Office of Management and Budget.

a. Research, development, test, and evaluation.

When programs or proposals are reestimated in isolation of the total request, however, CBO often has different estimates. For example, the Administration has proposed changes in the Davis-Bacon Act and the Service Contract Act, which require the payment of prevailing wages on most construction and other government contracts. If enacted, the proposal would reduce budget authority by about $310 million in 1989 according to Administration estimates, but by only $149 million according to CBO estimates. In another example, the Administration estimates the cost of civilian pay raises to be higher than CBO does, but CBO is not reestimating the pay raise allowance because it is at the Administration's discretion to request whatever amounts it believes are needed.

TABLE IV-3. ANNUAL REAL GROWTH IN DEFENSE SPENDING AUTHORITY (By fiscal year, in percent change)

Account	1981	1982	1983	1984	1985	1986	1987	1988	1989
Military Personnel	2	2	2	2	1	2	2	a/	a/
Operation and Maintenance	9	6	5	5	6	-4	3	-3	2
Procurement	25	25	17	3	6	-6	-8	-3	-8
RDT&E	13	14	10	14	10	7	3	-1	-1
Military Construction	39	38	-12	-3	17	-7	-5	3	1
Family housing	21	4	20	-5	5	-6	8	a/	-2
Subtotal, Department of Defense--Military	13	12	7	5	6	-2	-2	-2	-2
Other Defense	18	16	24	6	9	-4	a/	a/	2
Total	13	12	8	5	6	-2	-2	-2	-2

SOURCE: Congressional Budget Office.

NOTE: The figures shown in this table adjust budget authority for transfers and rescissions of unobligated balances. They are conceptually similar to total obligational authority. The 1986 column incorporates the reductions made under the Balanced Budget Act.

a. Less than 0.5 percent.

Given the Administration's budget proposals, CBO estimates that outlays for defense programs will total $294.5 billion in 1989--$0.5 billion higher than the outlay total in the Administration's budget and the budget summit. This difference should not be viewed as significant; it is well within the normal statistical error of outlay estimating. Outlays under the Administration's program could be higher or lower than CBO estimates by billions of dollars. Since total defense budget authority has been relatively stable since 1985, however, the range of error in current estimates is probably less than $6 billion or plus or minus 1 percent.

Table IV-4 shows that CBO has higher outlay estimates than the Administration in some categories and lower estimates in others. In making its outlay estimates, CBO uses historical spendout rates, including an allowance for estimated lapses--appropriations that will never be spent. There is much room for error in estimating how much of an appropriation will be spent in a given year and how much will never be spent; in many cases, these are analytic judgments over which people can differ. For each of the categories shown in the table, CBO has attempted to have the probability of underestimating outlays equal to that of overestimating them.

CBO's higher estimate for 1989 is rooted in its higher estimate for 1988. As Table IV-4 shows, CBO estimates that outlays in 1988 will total about $287.5 billion--$2.1 billion more than does the Administration. This estimate is consistent with recent reports from the Department of Treasury. According to these reports, 1987 outlays were $1.5 billion higher than CBO previously estimated, and very strong defense spending had taken place in the first four months of the fiscal year. A year-over-year extrapolation for 1988 shows outlays totaling about $294 billion for just the Defense Department's portion of the defense function, while time-series projections show an amount slightly higher than that.

Finally, the Administration will propose legislation that would increase the Secretary of Defense's authority to transfer funds between accounts and would broaden the foreign currency fluctuation account so that it could receive expired funds from all DoD accounts and provide funds for military personnel. These proposals are discussed in more detail below in the section on operation and maintenance. If these proposals are enacted, outlays would increase by about $2.6 billion in 1988 to about $290 billion (budget authority would also increase--by about $1.6 billion--since the transfer of expired spending authority would be treated as a reappropriation).

MAJOR DEFENSE PROPOSALS

The Administration's priorities in its defense budget are military pay, readiness, and efficient weapons acquisition. To fund these priorities, the Administration has emphasized reductions in force structure, weapons cancellations and deferrals, reduced research and development, and lower personnel strengths. The Administration often character-

TABLE IV-4. REESTIMATES OF THE PRESIDENT'S 1989 REQUEST FOR FUNCTION 050: NATIONAL DEFENSE
(By fiscal year, outlays in billions of dollars)

Account	1988	1989	1990	1991	1992	1993
President's 1989 Budget	285.4	294.0	306.2	320.2	335.4	351.3
Reestimates						
Military personnel	-0.1	0.4	0.5	0.5	0.5	0.5
Operation and maintenance	-0.4	0.4	0.2	-0.3	0.0	-0.1
Procurement	1.7	0.9	0.7	2.2	1.2	0.3
RDT&E a/	0.6	-0.7	-0.9	-1.2	-1.2	-1.3
Military construction	-0.1	-0.6	-0.4	-0.5	-0.4	-0.2
Family housing	-0.1	-0.2	-0.3	-0.2	-0.2	-0.1
Other	0.5	0.4	0.3	0.2	0.1	0.1
Total Reestimates	2.1	0.5	0.2	0.8	0.1	-0.7
President's 1989 Budget as Estimated by CBO	287.5	294.5	306.4	321.0	335.5	350.6

SOURCE: Congressional Budget Office.

izes its current request for 1989 in terms of changes from its request of a year ago. But this report focuses on a comparison of the Administration's proposals with the CBO baseline, which is a projection of 1988 appropriations in real terms. This chapter, therefore, often compares the Administration's defense proposals for 1989 with 1988 program and funding levels.

Table IV-5 illustrates the importance of reference points when discussing increases and cuts in the defense budget. The force reductions stressed by the Administration are shown in the fourth column of the table, which shows changes from last year's proposals for 1989. Sea-launched ballistic missiles (ICBMs), Air Force and Marine Corps tactical aircraft, nuclear attack submarines, and other warships are reduced from the Administration's biennial request. In comparison to 1988, however, some of the same forces show increases (see the third column); sea-launched ICBMs, Marine Corps tactical aircraft, and nuclear attack submarines are shown in greater numbers than 1988. In the case of just one force component, the 656 sea-launched ICBMs currently planned for 1989 represent a cut of 8 missiles from last year's plan for 1989 and an increase of 32 from the current plan for 1988.

The following sections of this chapter discuss the Administration's program and priorities in more detail, and each contains a table showing the changes in the 1989 request from the CBO baseline and from last year's request for 1989.

Military Personnel

Military personnel appropriations fund the pay and allowances of members of the active and reserve forces. The Administration has requested $2.3 billion more for 1989 than was appropriated for these accounts in 1988--though about $0.9 billion less than the CBO baseline--for a total of $78.4 billion. This amount includes the cost of the Administration's proposal to raise military pay by 4.3 percent effective January 1, 1989. It does not, however, include $54 million as the cost of a proposed bonus for Air Force pilots choosing to stay in the service. Nor does it include cuts in officer strength that are required by law for 1989 and 1990; the cuts for 1989 would reduce the request by about $100 million.

TABLE IV-5. SUMMARY OF ACTIVE FORCES
(By fiscal year, in numbers)

Category	1988	1989	Change from 1988 to 1989	Change from Previous 1989 Plan
Strategic Forces				
Land-Based ICBMs	1000	1000	0	0
Strategic Bombers	372	372	0	0
Sea-Launched ICBMs	624	656	32	-8
Strategic Interceptors	36	36	0	0
General Purpose Forces				
Army Divisions	18	18	0	0
Marine Corps Divisions	3	3	0	0
Air Force Tactical Aircraft	1,762	1,746	-16	-28
Navy Tactical Aircraft	758	792	34	34
Marine Corps Tactical Aircraft	334	341	7	-10
Naval Forces				
Aircraft carriers	14	14	0	0
Battleships	3	4	1	0
Nuclear attack submarines	96	99	3	-2
Other warships	204	200	-4	-18
Amphibious assault ships	62	65	3	0
Airlift and Sealift Forces				
C-5 Aircraft	98	110	12	0
Other Air Force Aircraft	812	804	-8	0
Navy and Marine Corps Tactical Support Aircraft	92	92	0	0
Ships	61	61	0	0

SOURCE: Compiled by Congressional Budget Office based on data supplied by the Department of Defense.

NOTE: Aircraft are in terms of primary aircraft authorized.

The $0.9 billion savings from the CBO baseline occur for several reasons related to personnel levels and compensation policies. The baseline assumes that the number of people in the military are the same--on average--as now on duty. But the Administration's request would reduce average strength by about 13,000 active-duty people; at the same time, it would offset this reduction with an increase in average strength of about 5,000 reserve personnel (see Table IV-6). (In terms of end-of-year strength, another common measure of personnel levels, the Administration proposes almost no change in either active or reserve levels. It has, however, reduced 1988 personnel levels from those authorized under current law.) This reduction in active-duty strength saves about $255 million, while the increase in the reserves

TABLE IV-6. REQUESTED STRENGTH LEVELS FOR MILITARY PERSONNEL (By fiscal year, in percents, and average personnel levels in thousands)

Service	1989 Request (Thousands of people)	Change from 1988		Change from Previous Request	
		People	Percent	People	Percent
		Active			
Army	764	-5	-1	-17	-2
Navy	592	7	1	-4	-1
Marine Corps	197	-1	a/	-3	-1
Air Force	579	-15	-2	-22	-4
Subtotal	2,132	-13	-1	-46	-2
		Reserves			
Full-time	71	1	2	-5	-6
Part-time	1,067	4	a/	-51	-5
Subtotal	1,138	5	a/	-56	-5
Total	3,270	-8	a/	-102	-3

SOURCE: Compiled by Congressional Budget Office based on data supplied by the Department of Defense.

a. Less than 0.5 percent.

would cost about $65 million. Compared with last year's request, this request represents a greater reduction in total military personnel--about 102,000 people measured in average strength.

The President's budget would raise military pay by 4.3 percent effective January 1, 1989, at a total cost of about $2.2 billion. For the 1989-1993 period, the request calls for pay raises averaging 4.3 percent compared with 4.0 percent for the CBO baseline. The President's request and the CBO baseline have two other differences aside from the pay raise percentage. The Administration would provide the pay raise in January instead of October, and it would not require any "absorption"; the CBO baseline assumes about 15 percent absorption. (Absorption refers to the practice of requiring federal agencies to fund some portion of higher pay costs out of existing appropriations instead of the Congress's providing additional funding to cover the full cost.) Taken together, the percentage increase, the timing, and the absorption rate cause the Administration's proposal for military pay costs to be a net $2.4 billion over the CBO baseline for the 1989-1993 period.

The Administration hopes to persuade the Congress to repeal a current law calling for reductions in the numbers of officers relative to enlisted personnel. As a result, the request includes about $100 million for higher officer strengths than, in fact, current law allows. In the authorization bill for 1987, the Congress called for officer strengths to be reduced--relative to enlisted strengths--by 6 percent by the end of 1989. The legislation reflected a view that growth in the officer corps was poorly justified and contributed to "redundant headquarters and overblown staffs." The Department of Defense (DoD) has argued, however, against the officer reductions on grounds of its needs for combat readiness and compliance with other laws pertaining to personnel management. Consequently, in its authorization bill for 1988, the Congress adhered to its goal, but granted DoD an additional year to achieve the reductions. DoD will submit a report to the Congress in March 1988, reiterating its position that the law should be repealed. 1/

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1. For an analysis of this issue, see Congressional Budget Office, "Reducing the Size of the Military Officer Corps: Effects on Promotions and Accessions," Staff Working Paper, February 1988.

Operation and Maintenance

The operation and maintenance (O&M) accounts fund a wide range of activities--some directly related to force operations, such as training exercises, weapons maintenance, supplies, and other logistical support. O&M also funds personnel support activities that are only indirectly related to force readiness--for example, training of individual members (apart from training in units), medical care, and military base or community services.

Overall, new budget authority would grow by about 2 percent in real terms in 1989. All O&M programs share in the real growth, except for reserve forces, which show a decline (see Table IV-7 where differences from the CBO baseline approximate differences in real terms). In contrast, the Administration's current O&M request falls short of its plan of a year ago in almost every program.

The Air Force's O&M budget request accounts for more than half of the overall growth in O&M from CBO baseline levels. The Air Force will operate only 16 fewer tactical aircraft in 1989 than in 1988, despite realigning its force structure to 36 equivalent tactical air wings instead of 38 wings. Even with this force reduction and a cut of 14,646 in average active-duty personnel levels, the Air Force's operation and maintenance budget would grow by over 5 percent in 1989, or $1.2 billion in real terms.

The Navy's request for O&M is slightly below the CBO baseline. At the same time, active-duty average personnel levels rise by 7,425 people and forces show a net increase over 1988 levels. The Navy proposes retiring eight frigates, but also proposes operating an additional battleship, three more attack submarines, three more amphibious assault ships, and four more other warships. The Navy is restructuring its air forces to have one fewer air wing, while actually operating 34 more aircraft overall.

The O&M requests for the Army and Marine Corps also show slight decreases from the CBO baseline, and both show declines in active-duty military personnel levels as well--5,223 for the Army and 698 for the Marine Corps. The Army's force structure would also be reduced slightly: a light infantry brigade would be deactivated, and 450 utility helicopters would be eliminated from the force.

Moreover, the Administration has requested appropriations to employ about 1,102,000 civilians, most of whom are funded by O&M. This amount represents a decrease of nearly 1 percent from the baseline and a reduction of 2 percent compared with the Administration's previous request. The request also seeks a civilian pay raise of 2 percent to be effective January 1, 1989. This is the same pay raise granted to both military and civilian personnel in 1988, but is smaller than the 4.0 percent raise assumed in the CBO baseline. The reduction in strength saves about $140 million compared with the CBO baseline, and the pay raise reduction saves about $0.7 billion.

TABLE IV-7. NOMINAL CHANGES IN OPERATION AND MAINTENANCE (By fiscal year, in billions of dollars of budget authority and percent changes)

Activity	1989 Request (Dollars)	Change from CBO Baseline		Change from Previous Request	
		Dollars	Percent	Dollars	Percent
Strategic Forces	4.8	0.3	6	-0.7	-12
General Purpose Forces	24.8	0.7	3	-2.4	-9
Intelligence and Communications	8.4	0.2	2	-0.7	-8
Airlift and Sealift	1.7	0.1	8	-0.1	-7
Reserve Forces	6.6	-0.3	-5	-0.7	-10
Central Supply and Maintenance	21.3	--	a/	0.2	-1
Training, Medical, and Other	14.0	a/	a/	-0.8	-5
Administration and Associated Activities	3.5	0.2	5	-0.1	-2
Support of Other Nations	0.3	--	1	0.0	2
Special Operations Forces	0.4	0.1	18	0.4	b/
Total	85.6	1.1	1	-5.3	-6

SOURCE: Compiled by Congressional Budget Office based on data supplied by the Department of Defense.

a. Less than 0.5 percent.

b. New category.

The Administration has two legislative proposals that, because of unforeseen events like recent unfavorable changes in the exchange rate, would allow funds from other DoD accounts to be extensively transferred into the operation and maintenance accounts. CBO estimates that these proposals would raise outlays in 1988 by about $2.6 billion. Foreign currency fluctuations affect the O&M accounts more than any other defense accounts, since O&M funds the costs of overseas bases. (Military personnel costs are also affected because servicemen may receive an overseas stationing allowance.) One of the Administration's proposals would raise the general transfer authority accorded the Secretary of Defense from $1.5 billion to $4.0 billion. With this authority, the DoD could transfer funds from the slow-spending procurement accounts into the faster-spending O&M and military personnel accounts.

The second proposal centers on a revolving fund the Congress established in 1979 to ease the adjustment to currency fluctuations. The fund can be drawn down by the O&M accounts when the dollar depreciates, but is replenished by O&M when the dollar appreciates. Because the current balance in the revolving fund is very low, the Administration is seeking legislation that would allow DoD's expired unobligated balances to be transferred to the revolving funds for subsequent withdrawal, not only by the O&M accounts but also by the military personnel accounts. A similar proposal is being made for a currency fluctuation account for military construction.

This second proposal would raise both budget authority and outlays in 1988 and later years. It would raise outlays because funds that would never be spent in the original account would be spent in O&M. (For example, under current law, DoD loses the authority to obligate and spend some procurement funds after a certain number of years, but under this proposal DoD would be given a second opportunity to spend the funds after they had been transferred to the foreign currency revolving fund.) This proposal would also raise budget authority in all years as funds are "reappropriated" from their original purpose to the new purpose of capitalizing the revolving fund for foreign currency fluctuations.

Procurement

The procurement accounts fund the purchase of weapons and other equipment. The weapons purchased in these accounts include new ships, aircraft, missiles, and combat vehicles such as tanks. The procurement accounts also fund major modification or weapons improvement programs, as well as spare and repair parts. Other purchases include trucks, bridging equipment, radios, and satellites. As shown in Table IV-8, the procurement accounts decline by 8 percent, or about $7.4 billion from 1988 in real terms. This request would be the fourth consecutive year of real decline in procurement budget authority; still, the increases between 1981 and 1985 were great enough that procurement in 1989 would be 50 percent higher in real terms than in 1980.

Compared with the request for 1988, this year's procurement request includes a mixture of program cancellations, stretch-outs, and accelerations. The Administration would cancel some programs because it does not consider them to be affordable--for example, the Army's remotely piloted surveillance vehicle called Aquila, the Copperhead laser-guided projectile, and improvements to Minuteman III missiles that would allow better penetration of enemy airspace. Other weapons would be canceled because the Administration considers alternatives more effective. For example, the Navy would upgrade a current version of the A-6 attack aircraft rather than buy a new version of the same aircraft--the A-6F--and the Air Force would charter aircraft instead of buying the C-27. The Administration includes only $200 million in development funds in its budget for the small ICBM popularly called Midgetman; this amount would keep the program going despite the Administration's opposition to it, and essentially would leave the program up to the next Administration. Finally, against its preferences but because of a Congressional ban on testing, the Administration would cancel the ASAT, an antisatellite program (see Table IV-9).

The budget also includes a number of stretch-outs and accelerations, as is common in annual requests. For some weapons, the Administration proposes buying fewer quantities in 1989 than in 1988; quantities are reduced for five major aircraft programs, nine missile or rocket systems, and the M-1 tank. Other weapons would be purchased at higher rates in 1989, including four aircraft programs and four-

TABLE IV-8. NOMINAL CHANGES IN PROCUREMENT
(By fiscal year, in billions of dollars of budget authority and percent changes)

Activity	1989 Request (Dollars)	Change from CBO Baseline		Change from Previous Request	
		Dollars	Percent	Dollars	Percent
Aircraft	17.4	3.9	29	2.7	19
Support and Other Equipment a/	16.5	-3.8	-19	-7.1	-30
Other Missiles, Torpedoes, and Weapons	9.2	1.0	13	-1.9	-17
Shipbuilding and Conversion	9.1	-7.7	-46	-2.7	-23
Communications and Electronic Equipment	6.8	-0.5	-7	-2.6	-27
Spares and Repair Parts	5.7	0.4	7	-0.5	-8
Vehicles, All Types b/	4.3	-0.3	-7	-0.5	-10
Ammunition, Munitions, and Related Equipment c/	4.2	-0.1	-2	-0.8	-16
Modifications	4.0	0.1	3	-0.3	-7
Ballistic Missiles	2.7	-0.3	-11	-1.0	-28
Total	80.0	-7.4	-8	-14.6	-15

SOURCE: Compiled by Congressional Budget Office based on data supplied by the Department of Defense.

a. Includes National Guard and Reserve equipment.
b. Includes Army weapons and tracked combat vehicles, but excludes all Navy, National Guard, and Reserve vehicles, which are included in the category of Support and Other Equipment.
c. Excludes Navy purchases of air-launched ordnance, which is included in the category of Support and Other Equipment.

TABLE IV-9. PROGRAM TERMINATIONS IN THE ADMINISTRATION'S 1989 BUDGET (Budget authority, in millions of dollars)

Weapon	1988	Previous 1989 Plan
Army Programs		
Aquila Remotely Piloted Vehicle	0	238
Anti-Tactical Missile	22	86
EH-60 Helicopter	7	57
120mm Mortar	0	24
M-198 Howitzer	0	20
Copperhead Laser-Guided Projectile	118	106
Navy Programs		
A-6F Aircraft a/	0	983
Naval Airship	25	62
Anti-Radiation Seeker	14	17
High Frequency Anti-Jam Radio	b/	52
5-inch Guided Projectile	0	0
Skipper Laser-Guided Bomb	39	37
Air Force Programs		
ASAT Space Defense System	148	784
Midgetman ICBM	682	2,350
Minuteman III Penetration Aids	b/	130
C-27 Aircraft	0	70
AGM 130 Rocket-Powered Bomb	1	122
Airborne Command Post Replacement	0	14
Total	1,055	5,153

SOURCE: Compiled by Congressional Budget Office based on data supplied by the Department of Defense.

a. The budget refers to this program as "remanufactured A-6E."

b. Costs are not available at this time.

teen missile systems or torpedoes. Production slowdowns can add to unit costs, since fixed costs are spread over fewer systems and economies of larger-scale production go unrealized; production accelerations can have the opposite effects. Generally, however, the effects of production rates on unit costs vary widely for weapons systems. The costs of some systems appear to be relatively insensitive to production rates; at the same time, other systems show significant savings when produced at higher rates.

The following sections discuss the procurement proposals in more detail. The sections on aircraft, missile, and vehicle procurement highlight some of the wide variations in unit costs that can be attributed to some combination of production rates and other program changes--for example, procurement of an improved weapon.

Aircraft. The largest single category of procurement in 1989 will be aircraft, although fewer aircraft would be purchased than in any year since 1978. In 1988, the Department of Defense will buy about 660 aircraft, but in 1989 the number would fall to 617 (not counting purchases of the B-2A or Stealth bomber, which are classified). Four programs would be purchased at higher rates in 1989, and all of them show declines in unit cost; the most expensive of these four--the C-17 airlift aircraft--would see a declining unit cost of 25 percent, since the Air Force would buy four airplanes in 1989 compared with two in 1988 (see Table IV-10). Four of the five aircraft purchased in lower numbers in 1989 show unit cost increases, the largest of which occurs in the EA-6B--a Navy aircraft with computer-controlled electronic warfare capability--where unit costs increase 41 percent. Unit costs for the F/A-18 and the F-15 both increase by 13 percent. Nine aircraft and helicopters show no change in numbers bought; five of them have unit cost increases and four unit cost decreases. Because of a qualitative change in the program, the Air Force's F-16 fighter is 26 percent more expensive in 1989 than it was in 1988.

Support Equipment. The second largest single activity within the defense procurement accounts for 1989 is support and other procurement. Its large absolute and relative size stems from several factors: "other procurement" is itself a large category; moreover, all major weapons systems require general and sometimes specialized equipment for maintenance and test purposes. CBO has included defense

TABLE IV-10. SELECTED PROGRAM CHANGES IN THE 1989 REQUEST FOR AIRCRAFT PROCUREMENT (By fiscal year, in billions of dollars of budget authority and percents)

Program	1989 Request		Percent Changes from 1988	
	Quantity	Dollars	Quantity	Unit Cost
Increases				
E-6A Aircraft	7	364	133	-17
RC-12 Aircraft	6	106	100	-23
C-17 Aircraft	4	1,108	100	-25
T-45TS Aircraft	24	429	100	-50
Decreases				
MC-130H Aircraft	4	227	-43	11
EA-6B Aircraft	9	511	-25	41
F/A-18 Aircraft	72	2,359	-14	13
F-15 Aircraft	36	1,506	-14	13
AH-64 Helicopter	72	891	-6	-2
No Changes				
F-16 Aircraft	180	3,705	0	26
SH-60F (CV ASW) Helicopter	18	386	0	17
AV-8B Aircraft	24	568	0	13
F-14 Aircraft	12	910	0	10
SH-60B Helicopter	6	121	0	4
UH-60 Helicopter	72	495	0	-5
CH/MH-53E Helicopter	14	208	0	-6
E-2C Aircraft	6	355	0	-12
Civil Air Patrol Aircraft	38	1	0	-68

SOURCE: Compiled by Congressional Budget Office based on data supplied by the Department of Defense.

agency purchases and procurement of equipment for the National Guard and Reserves in this category. These purchases include everything from photographic equipment and vehicles to training devices, missiles, and aircraft. Budget details were not available to permit a breakout of the data. While not part of all weapons systems, support equipment is an important part of all weapons programs. In real terms, funding requested for this category is about 19 percent ($3.8 billion) lower than in 1988.

Missiles. The Administration requests about $9.2 billion to purchase an assortment of tactical and strategic missiles and torpedoes--one of four categories of weapons that have real growth in 1989. The total number of air-to-air, air-to-surface, and surface-to-air missiles would remain at about the same level as in 1988, but fewer surface-to-surface missiles would be purchased primarily because of cutbacks in an Army rocket system. Of the 14 weapons in the other missile and torpedo category showing higher production rates in 1989, 10 have lower unit costs (see Table IV-11). Five of the nine missile or rocket programs with lower production rates show higher unit costs.

Shipbuilding and Conversion. The Navy is requesting $9.1 billion to construct new ships and to modify or convert older ships. This amount is substantially less than was appropriated for 1988, but last year's appropriation contained about $6.3 billion for two nuclear-powered aircraft carriers. This year's request contains $8.9 billion for the construction of 17 new ships, including $2.2 billion for three AEGIS destroyers, $1.6 billion for two Los Angeles-class attack submarines, $1.5 billion for the SSN-21 (the lead ship of a new class of attack submarines), and $1.4 billion for a Trident ballistic missile submarine. The Navy seeks $0.2 billion in advance funding to extend the service life of a conventionally powered aircraft carrier, the U.S.S. Constellation, and to modernize two oil-bearing ships.

Communications Equipment. The funding request for communications and electronic equipment ranges from radios for tactical forces to fleet ballistic missile support equipment. After adjustments for inflation, funding requested for this category is 7 percent lower than in 1988. The largest single program is the Army's Mobile Subscriber Equipment (MSE)--field telephones--which accounts for $1.0 billion of

TABLE IV-11. SELECTED PROGRAM CHANGES IN THE 1989 REQUEST FOR OTHER MISSILES, TORPEDOES, AND WEAPONS PROCUREMENT (By fiscal year, in billions of dollars of budget authority and percents)

	1989 Request		Percent Changes from 1988	
	Quantity	Dollars	Quantity	Unit Cost
		Increases		
ALWT Torpedo	140	199	775	-84
AMRAAM Missile (Air Force)	1,470	831	268	-69
Chaparral Missile	368	61	202	-38
MK-48 ADCAP Torpedo	261	443	161	-34
HARM Missile (Navy)	1,307	306	71	-8
Stinger Missile (Army)	6,750	243	61	6
Phoenix Missile	560	466	60	-23
Stinger Missile (Marine Corps)	3,115	145	40	8
Dragon Missile (Marine Corps)	5,950	10	40	-15
Standard Missile (Medium Range)	1,635	701	25	-7
Patriot Missile	815	858	14	-19
Harpoon Missile	138	177	11	3
RAM Missile	260	53	8	4
Tomahawk Missile	510	733	7	-24
		Decreases		
Hellfire Missile (Navy)	200	9	-86	37
Maverick Missile (Navy)	731	83	-58	-13
HARM Missile (Air Force)	893	223	-46	5
Sparrow Missile (Air Force)	354	56	-37	1
MLRS Rocket System	48,000	416	-33	32
TOW Missile (Marine Corps)	2,585	28	-24	-6
Sidewinder Missile (Air Force)	760	48	-21	-4
HAWK Missile (Marine Corps)	467	140	-11	22
IIR Maverick (Air Force)	2,540	270	-6	-8
		No Change		
Hellfire Missile (Army)	5,000	181	0	4
TOW 2 Missile (Army)	12,000	149	0	-13

SOURCE: Compiled by Congressional Budget Office based on data supplied by the Department of Defense.

a $6.8 billion request. The MSE request is about the same as last year, though the Army's programs in general are about $0.3 billion lower. Navy and Air Force programs total about $0.2 billion below 1988, while Marine Corps programs receive a small amount of real growth.

Spare Parts. Funding for spare and repair parts programs would increase about 7 percent in real terms over 1988. A proposed increase in funding for Air Force aircraft and missile spares would be partially offset by a decrease for Navy aircraft and missile spares.

Vehicles. Funding for procurement of vehicles--primarily for the Army and Marine Corps--would fall by about 7 percent or $0.3 billion in real terms. In this category, DoD buys all kinds of vehicles from trucks and other wheeled support vehicles to tanks and other tracked combat vehicles; consequently, it is not easily summarized. The Army would buy 100 fewer M-1 or Abrams tanks for a total of 545 in 1989, and the Marine Corps would buy its first lot of M-1s with a purchase of 14 tanks. Procurement of Bradley Fighting Vehicles would decline by only five units. The Army would buy 80 vehicles designed to recover other vehicles damaged in battle, a system last purchased in 1986. Finally, the Army would not buy any field artillery ammunition carriers after buying 48 last year.

Ammunition. Like spare parts procurement, ammunition procurement is sometimes considered to be a readiness activity. The 1989 request would decrease departmentwide ammunition procurement by about 2 percent in real terms, largely because of planned termination of the Army's Copperhead laser-guided projectile. The Army's program includes $66 million for chemical weapons, and the Air Force and Navy programs contain about $100 million for a chemical weapon--the BIGEYE bomb.

Weapons Modifications. The budget for weapons modifications would increase by about 3 percent in real terms in 1989. Modifications of major weapons result both in small programs aimed at improving the reliability or maintainability of parts of a weapon and in large-scale programs that add new capabilities to existing weapons or extend their useful lives. The planned real growth in Army and Air Force aircraft modifications is partially offset by reductions in modifications of Navy aircraft.

Ballistic Missiles. Procurement of ballistic missiles in 1989 would total $2.7 billion--the smallest amount of all categories shown in Table IV-8--representing a real decline of about 11 percent or about $0.3 billion. While the number of missiles would be the same in 1989 as in 1988, the decline in funding results from an expected reduction in the unit prices for Trident II and MX missiles.

Research, Development, Test, and Evaluation

Research, development, test, and evaluation (RDT&E) funding is usually the first commitment to a weapons acquisition program, and it continues through the early stages of production. The Administration is seeking funds to sustain RDT&E funding at a 13 percent share of the total DoD budget--the same share as in 1987 and 1988. While real growth has averaged 9 percent since 1980, the 1989 RDT&E budget of $38.2 billion represents a real decrease in budget authority of $0.4 billion, or 1 percent below 1988 baseline levels.

Three of the activities in the RDT&E account would experience real growth, while three others would experience real decline (see Table IV-12). A 4 percent decrease would take place in the technology

TABLE IV-12. NOMINAL CHANGES IN RESEARCH, DEVELOPMENT, TEST, AND EVALUATION (By fiscal year, in billions of dollars of budget authority and percent changes)

Activity	1989 Request (Dollars)	Change from CBO Baseline		Change from Previous Request	
		Dollars	Percent	Dollars	Percent
Technology Base	3.3	-0.1	-4	-0.4	-10
Advanced Technology Development	6.5	0.9	15	-2.0	-23
Strategic Programs	6.5	-1.1	-14	-2.7	-29
Tactical Programs	13.1	0.4	3	-0.7	-5
Intelligence and Communications	4.5	-0.6	-11	-0.4	-8
Defensewide Mission Support	4.3	0.1	2	0.1	2
Total	38.2	-0.4	-1	-6.0	-14

SOURCE: Compiled by Congressional Budget Office based on data supplied by the Department of Defense.

base, in which basic research is conducted in areas involving physical, mathematical, environmental, engineering, biomedical, and behavioral sciences. Advanced technology development would grow about 15 percent, largely because of a proposed $4.5 billion request (a $1 billion increase) for the Strategic Defense Initiative. Whereas programs like SDI explore emerging technologies that have potential applications for defense, the request for RDT&E calls for a 14 percent real decrease in those strategic programs that have already passed these early developmental stages. The decrease in strategic programs is primarily caused by changes in classified programs, as well as a $0.5 billion reduction in the Trident II missile system, a $0.5 billion reduction in the small ICBM, and a $0.1 billion reduction in the B-1 bomber program.

The 3 percent growth in tactical programs for 1989 results from increases in a number of programs, the largest of which include the Navy's classified programs and the P-3 modernization program ($0.1 billion), the Air Force's Advanced Tactical Fighter ($0.2 billion), the Army's Light Armed Scout helicopter ($0.1 billion), and the advanced anti-tank weapon system ($0.1 billion). These and other increases are partially offset by reductions in the A-6 aircraft ($0.2 billion), joint tactical fusion program ($0.2 billion), attack submarine development ($0.1 billion), and many other programs. The decrease of 11 percent in intelligence and communications activities would be partially offset by a 2 percent increase in defensewide programs (that is, programs with many and diverse applications). The reduction in intelligence and communications programs is primarily the result of changes in classified programs.

Other Accounts

For fiscal year 1989, the Administration requests $5.7 billion for a variety of weapons and personnel programs funded in military construction accounts. This amount represents an increase of $389 million over the fiscal year 1988 budget--an inflation-adjusted increase of about 1 percent. The Administration's request for military construction would fund many projects within the United States and overseas, including Navy Strategic Homeporting ($220 million), the Strategic Defense Initiative ($90 million), and the Light Infantry Divisions in New York and Alaska ($214 million).

Like O&M and the military personnel accounts, the military construction accounts spend significant amounts overseas and are therefore affected by exchange rate fluctuations. The Administration proposes to transfer expired military construction and family housing funds to the foreign currency fluctuation account for these programs (see the section on operation and maintenance for an explanation of how a foreign currency fluctuation account works). The proposal would raise 1988 budget authority and outlays by about $150 million, since funds that are currently not available would be spent.

The budget for the Department of Energy contains $8.1 billion for defense activities for fiscal year 1989, an increase of over $300 million from the previous year. The activities funded in the defense function include the development and production of nuclear weapons as well as the production of nuclear materials. An increase of about $200 million for materials production accounts for much of the increase over last year's level.

CHAPTER V

THE ADMINISTRATION'S NONDEFENSE BUDGET

The President's proposals would result in nondefense outlays of $825 billion in 1989, an increase of 7 percent over the 1988 level and about 1 percent, or $10 billion, below the CBO baseline. Over the four subsequent years, growth in nondefense spending would average about 5.5 percent per year, about 0.5 percent below the growth in baseline each year. Total reductions in nondefense spending over the 1989-1993 period would be $99 billion relative to the CBO baseline.

The proposed domestic savings are much smaller than the President has requested in recent budget submissions. In both the 1987 and 1988 budgets, Presidential requests would have reduced domestic spending by more than $300 billion compared with CBO's baseline over a five-year period.

HUMAN RESOURCES PROGRAMS

Spending for human resources programs will account for over two-thirds of nondefense outlays in 1988. Under the President's proposals, outlays for such programs would continue to grow steadily through 1993, by an average of 6.8 percent per year. This growth rate is lower than the 7.2 percent annual growth rate in the CBO baseline. The resulting savings relative to the baseline would total $41 billion from 1989 through 1993, a 1 percent reduction. All human resources functions are targeted for reductions. (The dollar savings for each function are summarized in Table V-1; percentage reductions are in Table V-2.)

Medicare (function 570) is targeted for the largest dollar reductions in any nondefense program--$14.6 billion over the five-year period. The Administration proposes to lower payments to hospitals for medical education, reduce payments to physicians and suppliers,

TABLE V-1. CBO ESTIMATES OF THE ADMINISTRATION'S PROPOSALS IN NONDEFENSE SPENDING
(By fiscal year, in billions of dollars)

	Increase or Decrease (-) in Outlays Relative to CBO Baseline		
Budget Function	1989	1993	Total 1989-1993
Above Baseline Over Five Years			
Natural Resources, Infrastructure, and Other Government Services			
General Science, Space, and Technology (250)	1.5	5.4	19.5
Administration of Justice (750)	1.3	0.8	5.3
Subtotal	2.8	6.2	24.8
Below Baseline Over Five Years			
Human Resources			
Education, Training, Employment, and Social Services (500)	-0.8	-4.1	-10.3
Health (550)	-0.5	-1.7	-5.0
Medicare (570)	-1.0	-5.2	-14.6
Income Security (600)	-0.3	-1.1	-3.8
Social Security (650)	--	-0.5	-1.4
Veterans Benefits and Services (700)	-0.5	-1.2	-5.7
Subtotal	-3.2	-14.0	-40.6
Natural Resources, Infrastructure, and Other Government Services			
International Affairs (150)	-0.4	-1.6	-4.2
Energy (270)	-1.3	-1.2	-3.8
Natural Resources and Environment (300)	--	-4.1	-9.9
Agriculture (350)	-1.6	-2.1	-9.9
Commerce and Housing Credit (370)	-2.2	-3.1	-12.0
Transportation (400)	-0.9	-4.0	-12.8
Community and Regional Development (450)	-0.7	-2.6	-8.1
General Government (800)	-0.1	--	-0.3
Subtotal	-7.4	-18.6	-61.2
Other			
Net Interest (900)	-0.2	-5.0	-11.9
Allowances (920)	--	-0.1	-0.2
Undistributed Offsetting Receipts (950)	-2.3	-2.2	-10.3
Subtotal	-2.5	-7.2	-22.4
Total	-10.3	-33.6	-99.4

TABLE V-2. CBO ESTIMATES OF THE ADMINISTRATION'S PROPOSALS IN NONDEFENSE SPENDING (By fiscal year, in percentage differences from the CBO baseline)

Budget Function	Percentage Increase or Decrease (-) in Outlays Relative to CBO Baseline 1989	1993	Total 1989-1993
Above Baseline Over Five Years			
Natural Resources, Infrastructure, and Other Government Services			
General Science, Space, and Technology (250)	12.8	41.8	32.2
Administration of Justice (750)	15.1	7.4	10.8
Below Baseline Over Five Years			
Human Resources			
Education, Training, Employment, and Social Services (500)	-2.2	-10.4	-5.4
Health (550)	-1.0	-2.4	-1.6
Medicare (570)	-1.2	-3.8	-2.6
Income Security (600)	-0.2	-0.7	-0.5
Social Security (650)	-0.0	-0.2	-0.1
Veterans Benefits and Services (700)	-1.9	-3.8	-3.7
Natural Resources, Infrastructure, and Other Government Services			
International Affairs (150)	-2.4	-9.0	-5.0
Energy (270)	-28.1	-26.8	-16.8
Natural Resources and Environment (300)	-0.3	-22.3	-11.3
Agriculture (350)	-7.0	-12.9	-10.0
Commerce and Housing Credit (370)	-22.9	-93.8	-40.4
Transportation (400)	-3.2	-12.6	-8.6
Community and Regional Development (450)	-10.3	-35.6	-22.9
General Government (800)	-1.1	0.4	-0.6
Other			
Net Interest (900)	-0.1	-2.4	-1.2
Allowances (920)	a/	a/	a/
Undistributed Offsetting Receipts (950) b/	6.0	4.8	5.0

a. Baseline is zero.

b. Offsetting receipts rise, decreasing the deficit.

and raise SMI premiums. Other federal spending on Health (550) would be reduced $5.0 billion, primarily through regulatory initiatives in Medicaid and constraining the growth in Public Health Service funding to 1 percent per year from 1989 through 1993.

The Administration also targets Education, Training, Employment, and Social Services (500) and Veterans Benefits and Services (700) for five-year reductions of $10.3 billion and $5.7 billion, respectively. Several social service programs would be frozen at their 1988 levels, and education grant programs would be frozen after 1989, when funding would be increased above baseline levels. The President's budget requests an extension of the current loan origination fee in the VA's home loan guaranty program, assumes additional loan sales, and requests funding for the Veterans Medical Care program below baseline levels.

Social Security (650) and Income Security (600) are slated for reductions of less than 1 percent over the period. In Social Security, no benefit reductions are proposed, but administrative expenses would be held below the baseline. In Income Security, funding for the Low-Income Home Energy Assistance Program would be frozen at about 80 percent of its 1988 appropriation level from 1989 through 1993. The Administration is also requesting welfare reform, which CBO estimates will increase costs by $0.9 billion over the projection period.

NATURAL RESOURCES, INFRASTRUCTURE, AND OTHER GOVERNMENT SERVICES

Net spending on natural resources, infrastructure, and other government services currently accounts for less than one-sixth of nondefense outlays, or an estimated $121 billion in 1988. Under CBO baseline assumptions, spending for these programs and activities is expected to be about $134 billion in 1989 and to remain roughly constant at that level through 1993. The lack of growth in baseline spending over the 1989-1993 period occurs largely because projected growth in most discretionary spending is offset under current law by declining net outlays in a number of programs, including farm price supports and thrift insurance.

The President's budget proposals would reduce spending below the baseline in these areas by about 4 percent in 1989 and by about 5 percent through 1993. (In contrast, proposals in last year's budget would reduce spending in these functions by 15 percent below the baseline over the next five years.) Outlay savings would be about $5 billion in 1989 and about $36 billion over the five-year period. By 1993, outlays would be reduced to approximately the 1988 level.

The sharpest reductions are proposed for Commerce and Housing Credit (370), with outlay reductions relative to the CBO baseline totaling $12 billion over five years. The Administration would eliminate loans for small business assistance and for low-income rural housing (to be replaced in part by housing vouchers), and would reduce lending to finance construction of housing for the low-income elderly or handicapped. In addition, the Postal Service would have to raise rates to cover various costs that are now federally subsidized. On the other hand, large increases would be provided to the Census Bureau to carry out the decennial census.

Spending for Community and Regional Development (450) would be reduced by almost a quarter, or $8 billion, relative to the CBO baseline over five years. Appropriations for Community Development Block Grants would be reduced, while Urban Development Action Grants and a variety of other grant and loan programs for both urban and rural areas would be terminated.

Other functions are also targeted for significant reductions. Energy (270) outlays would be reduced by $4 billion, or 17 percent, over the 1989-1993 period relative to the CBO baseline, largely by the elimination of Rural Electrification Administration (REA) loans and from the sale and prepayment of existing REA loans. Conservation and research funding would be held below baseline levels, while spending would be increased for the Strategic Petroleum Reserve and nuclear waste disposal.

Spending for Natural Resources and Environment (300) programs would be reduced by about $10 billion, or 11 percent, below baseline levels over five years. Funding for the conservation reserve and for the Hazardous Substance Superfund would be increased, but spending would be below the CBO baseline for most other programs involving the environment, land management, recreation, and water and other natural resources. Agriculture (350) outlays would also be reduced by about $10 billion through 1993, largely by gradually eliminating farm ownership and operating loans, phasing out subsidized crop insurance, and reducing funding for agricultural research and services.

Transportation (400) spending would be $13 billion, or 9 percent, below the baseline during the five years. Reductions in outlays for mass transit, highways, and Amtrak would be partially offset by increased spending for the air traffic control system and the Coast Guard. Outlays for International Affairs (150) would be $4 billion below the baseline from 1989 through 1993, with most activities limited to growth at half the projected rate of inflation and no increase in aid to Israel and Egypt. The budget for General Government (800), with only minor cuts overall, includes reductions in payments to states, counties, and the District of Columbia, offset by increased outlays for federal buildings, the legislative branch, and other activities. Internal Revenue Service outlays would be approximately at baseline levels over five years.

Planned spending for functions 250 and 750 is above the baseline. General Science, Space, and Technology (250) is targeted for by far the greatest percentage increase in the budget, with outlays almost $20 billion, or 32 percent, above the baseline over the 1989-1993 period. The proposed space station and Superconducting Super Collider account for much of the increase, but funding above the baseline is also projected for space shuttle operations and National Science Foundation research programs. Additional spending for federal prisons and judicial activities bring outlays for Administration of Justice (750) above baseline levels by about 11 percent over five years, with expenditures for federal law enforcement roughly equal to the baseline through 1991 and below it thereafter.

OTHER NONDEFENSE SPENDING

The President's proposals for allowances, undistributed offsetting receipts, and net interest would result in net outlay reductions of $22 billion, relative to the baseline, over five years. Undistributed Offsetting Receipts (950) would be increased by about $10 billion, largely as a result of increased Postal Service payments to the Civil Service

Retirement Trust Fund, and the sale of the naval petroleum reserves and two power marketing administrations. Allowances (920) includes savings of $0.2 billion over five years, resulting from the Administration's proposal to increase the threshold for contracts covered by the Davis-Bacon Act and the Service Contract Act. Finally, outlays for Net Interest (900) would be reduced by about $12 billion over the 1989-1993 period, primarily because of the lower deficits estimated for the President's policies.

DETAILS BY BUDGET FUNCTION

The President's proposals for nondefense spending are discussed in more detail, by budget function, on the following pages. To facilitate comparisons with the CBO baseline, two types of adjustments have been made to the various functions--for credit reform and for pay allowances.

The President's budget includes a proposal to modify the budgetary presentation and the funding mechanism for credit programs in order to reflect more accurately their cost to the government. The present value of a credit subsidy would be charged to any agency making or guaranteeing loans, and funds would be appropriated to cover the estimated subsidy. Only the subsidies would appear in the agency accounts, while the actual cash flows would be reflected in centralized revolving funds in a new budget function (870). This change would not affect the deficit, but would result in different budget authority and outlays in affected accounts and functions. While CBO has urged the adoption of some form of credit reform, the CBO baseline cannot incorporate such changes until they are enacted into law. Therefore, in order to measure the President's proposals against the baseline, the credit reform adjustments were removed from the budget and the functional totals were modified to be con-sistent with the current budget system.

The President's budget also includes allowances for pay raises in function 920 in 1990 through 1993. In the CBO baseline, such increases are reflected in the individual functions. In the following tables, the allowances for pay raises in the budget have been allocated to the individual functions.

FUNCTION 150: INTERNATIONAL AFFAIRS

PROPOSED MAJOR SPENDING CHANGES
(By fiscal year, outlays in billions of dollars)

Item	1989	1990	1991	1992	1993	Cumulative Five-Year Changes
CBO Baseline	16.6	16.4	16.5	17.0	17.4	
Proposed Changes						
Foreign military sales	-0.1	-0.2	-0.4	-0.5	-0.5	-1.7
Multilateral development banks	0.0	0.1	0.2	0.2	0.2	0.6
Public Law 480	-0.1	-0.1	-0.2	-0.2	-0.3	-1.0
Other	-0.1	-0.1	-0.3	-0.6	-0.9	-2.1
Total	-0.4	-0.4	-0.7	-1.1	-1.6	-4.2
President's 1989 Budget as Estimated by CBO a/	16.2	16.0	15.8	15.9	15.9	
President's 1989 Budget a/	13.3	13.1	16.2	16.1	16.1	
CBO Reestimates	2.9	2.9	-0.4	-0.2	-0.3	5.0

a. Excludes the Administration's proposals for credit reform; includes allowance for pay raises in 1990 through 1993.

Proposed Policy Changes

The Administration's proposals for spending in the international affairs function are below CBO's baseline in all years. The request includes an increase in spending of 2 percent for 1989, consistent with the budget summit agreement, and of only half the projected rate of inflation in 1990 through 1993. Within the overall decrease in real resources, some programs fare better than others.

Foreign Military Sales Financing. Foreign military sales financing includes foreign military sales (FMS) credits and military assistance grants--financing to enable foreign countries to buy U.S. military equipment and services. The request is for a slight real increase in budget authority for the two accounts in 1989 and growth at half the rate of inflation in 1990 through 1993. The request would, however, reduce the faster-disbursing military assistance grants while increasing FMS credits, thus lowering estimated outlays in 1989 by $61 million but increasing them slightly over the five-year period. Financing for Israel and Egypt would be frozen over the five-year period. Since these two countries draw upon their financing faster than the program as a whole, estimated outlays for FMS are $1.7 billion below the CBO baseline.

All FMS credits are requested as forgiven loans--that is, no repayment is required. FMS credits would be grants in everything except name. This shift to grants is estimated to lower interest receipts in budget function 900 by $0.1 billion over the next five years. It has no effect on the international affairs function because of the long grace period on principal repayments.

Multilateral Development Banks. The United States negotiates with other donor countries with regard to the funding levels for the multilateral development banks. Agreements for replenishing the resources of these institutions usually cover a number of years. The Administration is requesting authorization for new replenishments for the general capital of the World Bank and the African Development Fund. It is requesting funding for all scheduled contributions and subscriptions of capital due in 1989, and funding of arrearages--scheduled funding denied in the 1988 appropriation bill--in 1990. Because of the slow disbursement rates and changes in the mix of funding, there would be no increase in outlays from baseline levels in 1989 but a $0.6 billion increase over the next five years.

Public Law 480 and Other Programs. Spending for these two categories would be below baseline levels by $3.1 billion over the next five years. Nearly one-third of the reduction would be in the Public Law 480 food-aid program, which would be cut by 9 percent in 1989. Spending for bilateral economic assistance programs of the Agency for International Development would be cut by $0.8 billion over the next five years. Credit program levels of the Export-Import Bank would increase by a nominal 2 percent, but the President is not requesting appropriations for the bank's tied-aid program.

The Administration is proposing increases over the next five years in two areas. Spending increases of $0.3 billion over the next five years for radio transmitter construction by the Board for International Broadcasting and the United States Information Agency would expedite completion of three major projects. After a one-year deferral of new construction funding for State Department embassy security, the Administration is requesting increases in spending totaling $0.3 billion over the next five years.

CBO Reestimates

Foreign Military Sales Refinancing. CBO estimates that collections from refinancing FMS loans with new guarantees, as authorized by the FMS debt reform program contained in the fiscal year 1988 continuing resolution, will be below the Administration's estimates by $2.3 billion in 1989 and $2.9 billion in 1990, but $0.3 billion higher in 1991 through 1993. The regulations governing this program will not be promulgated until late March, so both the Administration and CBO estimates are highly speculative. CBO believes, however, that the economic benefit to the few debtor countries that can take advantage of the refinancing program will lead to its completion in 1988.

The FMS refinancing program also affects the CBO estimate of the Guarantee Reserve Fund. The GRF is an account designed to cover late and rescheduled payments on guaranteed FMS loans financed by the Federal Financing Bank. The Administration assumes that several countries that have been chronically late in their payments or have rescheduled the payments of their FMS loans to the U.S. government will refinance their loans through the new guarantee program and stay current with their payments to private lenders. The Administration estimates this will reduce net claim payments by $0.3 billion in 1989 and $2.2 billion over the next five years. CBO does not assume any refinancing from these countries, thus eliminating these savings.

Export-Import Bank. The Administration estimates loan prepayments to the Eximbank of $0.5 billion in 1989. While the Eximbank has $2.4 billion in loan assets in highly credit-worthy countries, these loans are exclusively to private borrowers and carry interest rates of 8.0 percent to 8.375 percent. CBO does not believe these borrowers will find it economically advantageous to refinance the loans.

Exchange Stabilization Fund. The President's budget estimates interest income for the Exchange Stabilization Fund from its holdings of U.S. securities only. CBO estimates interest income on net equity, regardless of whether it is held in U.S. or foreign-denominated securities, resulting in an additional $0.2 billion of interest income in 1989 and $1.1 billion through 1993. Neither CBO nor the Administration makes an estimate of gains or losses from exchange fluctuations.

FUNCTION 250: GENERAL SCIENCE, SPACE, AND TECHNOLOGY

PROPOSED MAJOR SPENDING CHANGES
(By fiscal year, outlays in billions of dollars)

Item	1989	1990	1991	1992	1993	Cumulative Five-Year Changes
CBO Baseline	11.5	11.8	12.1	12.4	12.9	
Proposed Changes						
National Aeronautics and Space Administration	1.2	2.7	3.5	3.9	4.0	15.2
Department of Energy (General science)	0.3	0.5	0.5	0.6	0.6	2.4
National Science Foundation	0.1	0.2	0.3	0.5	0.8	1.9
Total	1.5	3.3	4.3	5.1	5.4	19.5
President's 1989 Budget as Estimated by CBO a/	13.0	15.1	16.4	17.5	18.2	
President's 1989 Budget a/	13.1	15.2	16.9	17.6	18.1	
CBO Reestimates	-0.1	-0.1	-0.5	-0.1	0.1	-0.7

a. Includes allowance for pay raises in 1990 through 1993.

Proposed Policy Changes

The President's proposals for function 250 would increase spending by 32 percent above the CBO baseline from 1989 through 1993; the 1989 appropriation request is 29 percent above that for 1988. All programs in this function--the National Science Foundation (NSF), Department of Energy (DOE) general science programs, and the space programs of the National Aeronautics and Space Administration (NASA)--would receive sizable increases.

Two major projects account for over half of the increase relative to the baseline: NASA's space station and the DOE's Superconducting

Super Collider (SSC). The spending levels for these two projects are $10.7 billion above the baseline over five years. The President's budget includes a three-year advance appropriation request for the space station: $967 million for 1989, $2.1 billion for 1990, and $2.9 billion for 1991. For the SSC, the President requests $363 million in new budget authority for 1989, and proposes a total of $2.5 billion from 1989 through 1993.

Funding for NASA's space flight, control, and data communications activities would also receive a significant increase under the President's budget. The proposed spending levels for this program are $4.3 billion (or 19 percent) above the baseline from 1989 through 1993. Most of this increase is earmarked for shuttle operations and the purchase of expendable launch vehicles.

Proposed spending for NSF programs is 20 percent above baseline levels for this period. The budget would increase funding for all NSF programs, including basic research on science, engineering, and mathematics, and science and engineering education activities. Included in the 1989 request for the NSF is $150 million to establish science and engineering centers at major research centers around the country; this request would provide five years of funding for these centers.

CBO Reestimates

CBO estimates that outlays in 1991 would be $500 million less than estimated in the budget, because of differing projections of spending rates for shuttle operations. Other estimating differences are small.

FUNCTION 270: ENERGY

PROPOSED MAJOR SPENDING CHANGES
(By fiscal year, outlays in billions of dollars)

Item	1989	1990	1991	1992	1993	Cumulative Five-Year Changes
CBO Baseline	4.8	4.8	4.4	4.2	4.6	
Proposed Changes						
Rural electrification	-1.7	-1.2	-1.5	-1.8	-2.1	-8.3
Conservation	--	-0.2	-0.2	-0.3	-0.3	-1.1
Energy R&D	-0.1	-0.1	-0.1	--	-0.2	-0.4
Sale of naval petroleum reserves and power marketing administrations a/	--	0.6	0.7	0.8	0.8	2.9
Strategic Petroleum Reserve	0.4	0.4	0.3	0.4	0.3	1.8
Nuclear waste disposal	--	0.1	0.2	0.2	0.2	0.9
Other	0.1	--	0.1	--	--	0.3
Total	-1.3	-0.2	-0.3	-0.7	-1.2	-3.8
President's 1989 Budget as Estimated by CBO b/	3.4	4.6	4.1	3.5	3.4	
President's 1989 Budget b/	3.1	4.5	4.3	3.8	3.5	
CBO Reestimates	0.4	0.1	-0.2	-0.3	-0.2	-0.2

a. The receipts from the proposed sale of the naval petroleum reserves and the Alaska and Southeastern power marketing administrations are shown in function 950. Outlays in function 270 would increase, relative to the baseline, after the proposed asset sales, because these assets would no longer generate receipts for the government.

b. Excludes the Administration's proposals for credit reform; includes allowance for pay raises in 1990 through 1993.

Proposed Policy Changes

The President is proposing substantial cuts in energy programs, which would reduce outlays to 28 percent below the CBO baseline in 1989. Outlay savings would total $1.3 billion in 1989 and $3.8 billion over the 1989-1993 period. These savings are net of losses in receipts that would result from the proposed sale of the naval petroleum reserves and the Alaska and the Southeastern power marketing administrations, and include outlay savings associated with prepayments and sales of Rural Electrification Administration (REA) loans. Excluding the outlay effects of all these asset sales, outlay savings would total about $3.1 billion from 1989 through 1993.

Rural Electrification. By far the largest savings in this function would occur in activities of the REA. The President proposes to stop making new federal loans to rural electric and telephone cooperatives after 1988, and to discontinue appropriations to the revolving fund that administers such loans. Instead, privately financed loans would be partially guaranteed by the federal government. In addition, borrowers could prepay existing REA loans under favorable terms. Any loans refinanced with private funds would receive only partial federal guarantees. The President also proposes to sell a portion of REA's loan portfolio each year, beginning in 1989. CBO estimates that total savings for these REA proposals would be $8.3 billion over the 1989-1993 period--$4.6 billion from the program reductions and $3.7 billion from loan sales and prepayments.

Conservation. Conservation spending in the budget is $1.1 billion, or 58 percent, below CBO baseline levels over five years. About $0.7 billion of this reduction would result from cuts in grants to states for energy conservation programs, with the remainder from reductions in conservation research and development activities.

Energy Research and Development. Under the President's proposed budget, federal efforts in energy research and development for fossil, solar, clean coal, and other energy technologies would be reduced by about $0.4 billion, or about 3 percent below baseline levels over the 1989-1993 period. The Administration believes that the government's role in energy research and development should be limited to basic research and long-term or high-risk projects. Partially offsetting the research and development savings is the President's proposal to implement the recommendations of the U.S. and Canadian Special Envoys on Acid Rain, which would add $1.8 billion in budget authority in the form of advance appropriations for clean coal technology over the 1990-1992 period. This proposal would increase spending by about $0.4 billion above the baseline level over the 1990-1993 period.

Naval Petroleum Reserves and Power Marketing Administrations. Income from the sale of the naval petroleum reserves and the Alaska and the Southeastern power marketing administrations appears in budget function 950 and is estimated to total $4.8 billion over the 1989-1990 period. These savings would be partially offset, however, by an increase in outlays in function 270, because these assets would no longer generate receipts for the government. In 1991, when all the proposed sales would be completed, the net loss of receipts would be $0.7 billion, and similar losses would occur in subsequent years. Over the five-year period, outlays in this function would increase relative to the CBO baseline by $2.5 billion because of the loss of receipts from the sale of the naval petroleum reserves, and by $0.4 billion because of the sale of the two power marketing administrations.

Strategic Petroleum Reserve. The President proposes to increase the rate of fill for the Strategic Petroleum Reserve (SPR) from the current rate of 50,000 barrels per day to at least 100,000 barrels per day, if the Administration's proposal to sell the naval petroleum reserves is also adopted. Increasing the fill rate would increase the five-year outlays for the SPR by $1.8 billion, raising them 70 percent above the CBO baseline. Under the President's budget, the SPR would reach the planned fill level of 750 million barrels by the end of 1993, about 6 years earlier than at the current rate of fill.

Nuclear Waste Disposal. The President's request for disposal of nuclear waste would result in additional spending of about $0.9 billion, or 44 percent, above the CBO baseline over the five-year period. The Nuclear Waste Policy Amendments Act of 1987 radically changed the nuclear waste program by authorizing the construction of a monitored retrievable storage facility, selecting the Yucca Mountain site in Nevada as the only site to be evaluated for the first repository, terminating all site-specific second repository work, and authorizing payments to Nevada. The President's request for this program is based on opening the first repository in 2003. However, the detailed schedule for implementing the 1987 amendments is not yet available.

Other. The President proposes to increase fees charged by the Nuclear Regulatory Commission from 45 percent of the agency's budget to 55 percent. Over the five-year period, this proposal would increase receipts by $0.5 billion.

CBO Reestimates

CBO's estimates of net outlays for function 270 under the President's budget proposals are below the Administration's estimates by $0.2 billion over the 1989-1993 period. The most significant estimating difference involves REA prepayments. The budget assumes that REA borrowers would prepay approximately $1.2 billion in loans in 1989. CBO estimates that such prepayments would total only $0.7 billion, because CBO projects that interest rates will be higher than assumed in the budget and therefore that fewer borrowers would choose to refinance. Also, the Administration considers Nuclear Regulatory Commission fees to be revenues, while CBO treats these fees as offsetting collections pursuant to the continuing resolution for 1988 appropriations (Public Law 100-202). CBO's treatment results in lower outlays and revenues (by about $1.3 billion over the five-year period), but has no net effect on the deficit.

FUNCTION 300: NATURAL RESOURCES AND ENVIRONMENT

PROPOSED MAJOR SPENDING CHANGES

(By fiscal year, outlays in billions of dollars)

Item	1989	1990	1991	1992	1993	Cumulative Five-Year Changes
CBO Baseline	16.3	17.1	17.5	18.0	18.4	
Proposed Changes						
Water resources	-0.1	-0.2	-0.5	-0.8	-1.1	-2.7
Conservation and land management						
Conservation reserve	0.7	0.8	0.8	0.7	0.7	3.7
ANWR mineral receipts	--	--	-1.6	--	-1.0	-2.6
Other	-0.3	-0.6	-0.7	-0.8	-0.9	-3.4
Recreational resources	-0.2	-0.4	-0.4	-0.5	-0.6	-2.1
Pollution control and abatement						
Construction grants	--	-0.2	-0.5	-0.9	-1.2	-2.8
Superfund	--	0.2	0.4	0.6	0.6	1.7
Other	--	--	-0.1	-0.1	-0.2	-0.4
Other natural resources	-0.1	-0.2	-0.3	-0.3	-0.4	-1.4
Total	--	-0.5	-3.0	-2.2	-4.1	-9.9
President's 1989 Budget as Estimated by CBO a/	16.2	16.6	14.5	15.8	14.3	
President's 1989 Budget a/	16.0	14.8	16.0	14.3	15.2	
CBO Reestimates	0.2	1.7	-1.5	1.6	-0.8	1.1

a. Includes allowance for pay raises in 1990 through 1993.

Proposed Policy Changes

The President's budget proposes spending levels for natural resources and the environment that are below the CBO baseline in all years, with total outlay savings of about $9.9 billion over the 1989-1993 period. Relative to the baseline, outlay savings for all natural resources spending would be $48 million in 1989. Funding for most activities in this function would be held below baseline levels, with the notable exception of hazardous waste removal ("Superfund").

Water Resources. The President is seeking a $6 million increase in discretionary budget authority over 1988 levels for water resources. This amount reflects a 2 percent increase ($74 million) in funding for water resource development by the Bureau of Reclamation and the Army Corps of Engineers, and a 38 percent ($71 million) decrease in funding for water conservation programs carried out by the Soil Conservation Service.

The total proposed funding level of $4.3 billion is 4 percent below the CBO baseline for 1989, with first year outlay savings of $137 million. Over the 1989-1993 period, the President's budget would result in outlay savings relative to the baseline of $2.7 billion.

Conservation and Land Management. The 1989 discretionary budget authority in the President's budget for conservation and land management activities reflects an increase of $0.4 billion above 1988 levels, and $0.2 billion above the CBO baseline, resulting primarily from proposed funding increases for the conservation reserve. Excluding the conservation reserve, the budget calls for a 10 percent decrease from 1988 to 1989 in discretionary spending authority for all other conservation and land management activities, including the Bureau of Land Management, the Forest Service, and the Soil Conservation Service.

From 1989 through 1993, the President's budget would decrease outlays relative to the baseline by $2.3 billion--an amount that reflects proposed leasing of federal lands for oil and gas exploration and production in the Arctic National Wildlife Refuge (ANWR) after 1990. Excluding the conservation reserve and proposed leasing of ANWR, outlay savings in conservation and land management programs would be $0.3 billion in 1989, and $3.4 billion over the 1989-1993 period.

Costs of the conservation reserve are paid from two sources: appropriations (shown in this function) and generic certificates redeemable for cash or agricultural commodities (resulting in Commodity Credit Corporation outlays in function 350). Under the President's budget, the conservation reserve would be funded by $1.9 billion in discretionary budget authority through the Agricultural Stabilization and Conservation Service (ASCS) and $300 million of generic certificates. These funds will be used to enter an additional 12 million acres of land into the reserve in 1989 and to make rental payments on contracts from previous years. The baseline includes $1.1 billion in discretionary budget authority through ASCS for the conservation reserve, as well as $1.0 billion in generic certificates to achieve the same program level. While proposed appropriations for the conservation reserve are above the CBO baseline for all years, the assumed use of generic certificates is less and total spending in the budget is at approximately the baseline level through 1993.

Recreational Resources. The President's budget reflects net funding cuts in 1989 budget authority for recreational programs of about 20 percent below the CBO baseline. The requested reductions would result in outlay savings of over $0.2 billion in 1989. Savings would be achieved primarily from large cuts in spending for acquisition of recreational lands (a cut of 87 percent) and construction of recreational facilities (reduced 82 percent). After 1989, these programs would be maintained at the proposed 1989 level. Outlay savings from these cuts and smaller reductions in operating or grant programs would total about $2.1 billion over the five-year period.

Environmental Resources. In 1989, requested appropriations for environmental programs would be about 9 percent below the CBO baseline, resulting in about $31 million in outlay savings for the year. Requested funding would continue to fall through 1993, when it would be about 32 percent below the baseline. Five-year cumulative outlay savings would be nearly $1.5 billion.

Estimated outlay savings are net of proposed spending increases for the Superfund program that are about 43 percent above the CBO baseline. The requested funding would increase outlays through 1993 by $1.7 billion, but these increases would be more than offset by the proposed phaseout of the wastewater treatment construction grants program, which would result in five-year savings relative to the CBO baseline of nearly $2.8 billion. Other proposals, including cuts for EPA operating programs, would yield further net savings of about $0.4 billion through 1993.

Other Natural Resources. The President proposes to decrease spending on other natural resources by $1.4 billion relative to the CBO baseline from 1989 through 1993. The majority of these spending reductions come from the operations, research, and facilities of the National Oceanic and Atmospheric Administration, which would be reduced by $0.9 billion over the five years. The Administration also proposes to sell all assets related to the Bureau of Mine's helium operations.

CBO Reestimates

CBO estimates that outlays under the President's proposals would be $1.1 billion higher over the five-year period than estimated in the budget. These reestimates result partly from different estimates of spending rates for ongoing programs, but about $0.8 billion of the increase stems from a different estimate of receipts that would result from opening ANWR to oil and gas exploration and development. CBO estimates that if the Congress acts in fiscal year 1988 to open ANWR to such activity, the first auction for drilling rights could not occur before 1991. The President assumes that leasing would begin in 1990. CBO also projects lower bonuses from competitive bidding than does the Administration.

FUNCTION 350: AGRICULTURE

PROPOSED MAJOR SPENDING CHANGES
(By fiscal year, outlays in billions of dollars)

Item	1989	1990	1991	1992	1993	Cumulative Five-Year Changes
CBO Baseline	22.6	22.1	20.2	17.5	16.0	
Proposed Changes						
Agricultural Credit Insurance Fund	-0.6	-0.7	-0.7	-0.6	-0.4	-2.9
Federal crop insurance	--	-0.1	-0.2	-0.3	-0.4	-0.9
Commodity Credit Corp. (Conservation Reserve)	-0.8	-0.9	-0.8	-0.7	-0.6	-3.8
Other	-0.2	-0.3	-0.5	-0.6	-0.6	-2.2
Total	-1.6	-2.0	-2.1	-2.1	-2.1	-9.9
President's 1989 Budget as Estimated by CBO a/	21.0	20.1	18.1	15.4	14.0	
President's 1989 Budget a/	21.7	19.6	18.7	17.6	16.2	
CBO Reestimates	-0.7	0.5	-0.7	-2.2	-2.2	-5.3

a. Excludes the Administration's proposals for credit reform; includes allowance for pay raises in 1990 through 1993.

Proposed Policy Changes

The Administration is proposing to reduce spending on agriculture by reducing direct loans to farmers provided through the Farmers Home Administration (FmHA), phasing out the federal subsidy for crop insurance, and reducing funding for agricultural research and services. Total programmatic savings relative to the CBO baseline would be $6 billion over the 1989-1993 period. In addition, the budget includes greater appropriations and less use of generic certificates than assumed in the baseline to fund the conservation reserve. As a result, outlays for the Commodity Credit Corporation (CCC) in this function are $3.8 billion below the CBO baseline over five years. The reduction is largely offset by greater outlays for the conservation reserve in function 300.

Agricultural Credit Insurance Fund. The President would continue to shift emphasis from government direct loans to federal guarantees of private loans, with total estimated savings of $2.9 billion over five years relative to the CBO baseline. For 1989, the President proposes a limit on direct loans of $500 million. This limit would decline by $100 million annually until 1992 when direct loans would be eliminated, except for emergency disaster loans.

Crop Insurance. The President again proposes reducing the federal role in providing crop insurance by eliminating subsidies for premiums paid by farmers and for administrative expenses over a five-year period beginning in 1990. This would be accomplished through substantial increases in farmers' premiums, followed by privatization of crop insurance services. Estimated savings would total $0.9 billion over the 1989-1993 period.

Other Agricultural Programs. The President proposes to eliminate the Temporary Emergency Food Assistance Program and to provide 1989 funding below 1988 levels for the Extension Service, the Agricultural Research Service, the Cooperative State Research Service, and the Animal and Plant Health Inspection Service. The estimated savings from these five programs would total $1.9 billion over the 1989-1993 period relative to the CBO baseline.

The President also proposes to reduce by $2 billion the current annual minimum of $5.5 billion in loans that are to be guaranteed by the federal government to finance foreign purchases of U.S. farm products. The President's proposal would not reduce guaranteed loan activity relative to the CBO baseline, since the baseline assumes that guarantees for fiscal years 1988 through 1993 will be at a level comparable to that used in 1987 and thus well below the current minimum.

The President's budget promises legislation to change the price support program for sugar. The Administration has not announced the details of its proposal, which would be aimed at making the program more market-oriented with no impact on the budget.

CBO Reestimates

CBO estimates that agriculture outlays under the President's budget for 1989 would be $0.7 billion lower than the Administration's estimate, with most of the difference in the CCC's price support program. CBO estimates that CCC outlays would be $0.5 billion lower than the Administration's estimate in 1989, because CBO's assumptions regarding 1988 crop market conditions are slightly more optimistic.

For 1990 through 1993, CBO outlay reestimates are also primarily a result of differences in CCC estimates. For 1990, CBO's CCC estimates exceed the Administration's by $0.4 billion. Most of this difference is caused by CBO's assumption that paid land diversions in feed grains would be continued for the 1990 and later crops, whereas the Administration assumes they will not. Differences in later years reflect a combination of more optimistic market conditions and CBO's assumption that target prices decline at a faster rate than is assumed in the Administration's estimates.

FUNCTION 370: COMMERCE AND HOUSING CREDIT

PROPOSED MAJOR SPENDING CHANGES
(By fiscal year, outlays in billions of dollars)

Item	1989	1990	1991	1992	1993	Cumulative Five-Year Changes
CBO Baseline	9.4	7.7	4.3	5.1	3.3	
Proposed Changes						
FmHA's Rural Housing Insurance Fund	-1.7	-1.5	-1.8	-2.0	-2.0	-9.0
Postal Service	-0.1	0.5	-1.0	-0.8	-0.7	-2.2
SBA business loans	-0.5	-0.6	0.1	--	--	-0.9
Other	--	1.0	-0.2	-0.4	-0.3	0.1
Total	-2.2	-0.6	-3.0	-3.2	-3.1	-12.0
President's 1989 Budget as Estimated by CBO a/	7.2	7.1	1.3	1.9	0.2	
President's 1989 Budget a/	5.1	5.3	3.9	2.6	2.6	
CBO Reestimates	2.1	1.8	-2.6	-0.7	-2.4	-1.7

a. Excludes the Administration's proposals for credit reform; includes allowance for pay raises in 1990 through 1993.

Proposed Policy Changes

The Administration's proposal would terminate or reduce a number of programs that currently support commerce or housing activities, and would require agencies to increase user fees or to sell assets to recover a greater portion of their costs. These changes would reduce outlays by about $2 billion in 1989, and by $12 billion through 1993.

Rural Housing Programs. Over the next five years, almost 75 percent of the outlay reductions in this function would involve activities of the Farmers Home Administration's (FmHA) Rural Housing Insurance Fund. Beginning in 1989, the President proposes to eliminate the current low-income rural housing assistance programs. Most of this assistance is provided in the form of reduced interest rates for mortgage loans to low-income households or to developers of low-income rental housing. FmHA's current supplemental rental payments program would also be eliminated. These programs would be replaced by housing vouchers that would pay part of the rental costs of low-income households (this new program would appear in budget function 600). According to Administration estimates, the funding sought in the budget would assist an estimated 21,200 households; by comparison, the baseline funding levels are estimated to be sufficient to provide in each year about 23,000 home-ownership loans and funding for about 15,500 rental units. The President's programmatic proposals would lower outlays in this function by about $0.7 billion in 1989 and by a total of $9.0 billion for the years 1989-1993 relative to the CBO baseline.

The President's budget also includes a proposal for the sale to the public in 1989 of $1.75 billion of direct loans previously made by FmHA. It is expected that these financial assets would be sold back to the federal government without any recourse. The sale of these loans would reduce federal outlays by an estimated $0.9 billion in 1989. Forgone loan repayments and interest receipts over the next five or six years would almost totally offset the 1989 savings.

Postal Service. The President is proposing to increase Postal Service payments to the Civil Service Retirement fund to cover the full cost of providing cost-of-living adjustments (COLAs) to Postal Service annuitants. Because the Postal Service is already required to increase its retirement payment in 1989, the President would allow the increased 1989 contribution for the cost of COLAs to be made in 1990, along with the 1990 payment; subsequent payments would be made on an annual basis. These payments, totaling about $3.6 billion over the next five years, are intragovernmental transactions and would be reflected as offsetting receipts in function 950. To recover these costs, the Postal Service would increase postal rates, resulting in net savings to the federal government.

The President is again proposing to eliminate the subsidy for revenue forgone, with the exception of the portion of the subsidy that covers free mail for the blind and for overseas absentee voters. This payment compensates the Postal Service for revenues lost as a result of reduced postage rates for certain classes of mailers--primarily nonprofit organizations, newspapers with a small circulation, and libraries. Rather than burden taxpayers with support for these subsidies, the President would eliminate eligibility for certain mailers and maintain the subsidy for the remaining groups by increasing rates for other classes of mail. These changes would reduce appropriations by $0.5 billion in 1989, and by $2.8 billion over the 1989-1993 period.

If these proposals are enacted, CBO estimates that the price of first-class postage would increase to 29 cents rather than 28 cents beginning in fiscal year 1991, as assumed in the baseline. Such an increase would generate an additional $5.2 billion in revenue relative to the baseline in 1991 through 1993. The combination of proposals affecting the Postal Service would result in increased net savings in this function of $2.2 billion, and increased receipts in function 950 of $3.6 billion, for a net spending reduction of about $5.8 billion relative to the baseline over the five-year period.

Small Business Administration. The Administration would end the Small Business Administration's (SBA's) direct loans for small business assistance, but would continue to provide guarantees of privately originated loans of $3.6 billion annually. However, the President would increase fees for certain guarantee loan programs, as well as fees for administrative purposes. The Administration would sell the entire portfolio of loans to development companies, as well as a sufficient number of general business loans to raise $140 million in both 1989 and 1990. Net proceeds from the asset sales over the five-year period are expected to be about $0.5 billion, in addition to programmatic savings in the business programs of $0.4 billion over the five-year period relative to the CBO baseline.

Other Commerce and Housing Credit Programs. Currently, the Department of Housing and Urban Development makes direct loans to nonprofit sponsors to finance the construction of housing for low-income elderly or handicapped residents. For 1988, the Congress has appropriated $566 million in direct loan authority, an amount estimated to be sufficient to finance the construction of over 11,000 units. The President has proposed funding of $350 million for 1989 to assist about 6,800 units. This level of assistance is projected for each year through 1993. The Administration's program reductions would not reduce federal outlays in 1989, but would save about $0.5 billion during the five-year projection period relative to the baseline. Savings would also be obtained by eliminating trade adjustment assistance to firms--a program administered by the International Trade Administration--and by imposing a travel promotion fee on airlines and cruise ships for transportation of passengers to the United States.

On the other hand, the budget includes spending increases for the Census Bureau to fund the 1990 decennial census. For 1989, the President proposes to increase funding for periodic censuses and programs by $221 million over the 1988 level. Because the baseline is based on 1988 appropriations, increased for inflation, it does not reflect the substantial costs of the decennial census. As a result, the budget includes outlays of $1 billion above the baseline in 1990 for the census. The President also proposes to increase funding for the Securities and Exchange Commission and the Commodity Futures Trading Commission to strengthen their enforcement and market surveillance activities.

CBO Reestimates

The President's 1989 budget for the first time treats as outlays all notes issued in assistance agreements by the Federal Deposit Insurance Corporation (FDIC) and the Federal Savings and Loan Insurance Corporation (FSLIC). These promissory notes are viewed as a way to liquidate the agency's obligations, while preserving cash. Outlays equal to the value of the note will be reflected when a note is issued, while subsequent payments on the note will no longer be counted as outlays. CBO projects that the total amount of assistance, both cash and notes, provided by the FSLIC and the FDIC to problem institutions will exceed the amounts estimated in the budget by $2.3 billion in 1989, $0.6 billion in 1990, and $0.5 billion in 1991. These estimates assume that problems in the real estate and energy markets, particularly in the Southwest, will continue for the next several years, and that the FSLIC and the FDIC will need to provide more assistance than assumed in the President's budget. CBO expects thrift insurance outlays to be lower than the Administration's estimates in 1992 and 1993.

CBO's estimates of Postal Service outlays are lower than the Administration's, particularly in the 1991-1993 period, for several reasons. The Administration's figures do not incorporate postal rate increases to finance its proposals to increase Postal Service contributions to the retirement fund, or the additional revenue required as a result of shifting the cost of subsidies for preferred rate mailers from the taxpayer to the ratepayer. In addition, the Administration's figures do not reflect the large year-to-year swings in net operating income that result from periodic rate increases. Over the 1989-1993 period, CBO's estimates of Postal Service outlays are about $5.2 billion below the Administration's.

CBO's estimates of net outlays for the Federal Housing Administration (FHA) are $0.2 billion less than the Administration's in 1989 and 1990, but greater in later years. Over the 1989-1993 period, CBO estimates that net FHA outlays will be $1.3 billion higher than assumed in the budget, largely because CBO expects the amount of claims paid annually to decline less rapidly over the next few years than does the Administration.

FUNCTION 400: TRANSPORTATION

PROPOSED MAJOR SPENDING CHANGES
(By fiscal year, outlays in billions of dollars)

Item	1989	1990	1991	1992	1993	Cumulative Five-Year Changes
CBO Baseline	28.0	28.8	29.8	30.6	31.7	
Proposed Changes						
Mass transit	-0.6	-1.0	-1.3	-1.5	-1.8	-6.2
Federal-aid Highways	-0.1	-0.7	-1.3	-1.7	-2.0	-5.9
Amtrak	-0.5	-0.6	-0.7	-0.7	-0.7	-3.2
FAA operations, facilities, and equipment	0.1	0.3	0.4	0.5	0.5	1.7
Coast Guard operations and acquisitions	0.2	0.3	0.4	0.4	0.4	1.7
Other	--	-0.1	-0.2	-0.3	-0.4	-0.9
Total	-0.9	-1.9	-2.7	-3.4	-4.0	-12.8
President's 1989 Budget as Estimated by CBO a/	27.1	26.9	27.1	27.2	27.7	
President's 1989 Budget a/	27.3	27.6	27.6	27.6	27.4	
CBO Reestimates	-0.2	-0.7	-0.4	-0.4	0.2	-1.5

a. Excludes the Administration's proposals for credit reform; includes allowance for pay raises in 1990 through 1993.

Proposed Policy Changes

The Administration's proposal would reduce transportation spending below the CBO baseline in all years, with total savings of $12.8 billion over the 1989-1993 period. The budget includes a 5 percent cut in 1989 budget authority ($1.5 billion), relative to the CBO baseline, resulting in first-year outlay savings of $0.9 billion.

Ground Transportation. Reductions in spending for ground transportation, particularly mass transit, would account for most of the outlay savings in this function. The Administration proposes to limit budget authority for transit programs to $1.5 billion annually, compared with 1988 budget authority of $3.3 billion. All but $128 million (for the Washington, D.C., transit system) would be financed from the transit account of the Highway Trust Fund, including spending for administration, planning, and research. This reduced transit program would provide grants to states and localities entirely by formula, with capital assistance going to all areas but with operating assistance restricted to small cities and rural areas. The Administration would place funding for interstate transfer grants for transit projects under the Federal-aid Highways obligation ceiling. Outlay savings for transit programs would total $6.2 billion over the 1989-1993 period.

The budget also includes reductions in the Federal-aid Highways program, which would be achieved by further reducing the obligation ceiling below the 1988 level and including currently exempt demonstration projects under the ceiling. Total annual obligations from the highway account of the Highway Trust Fund would be limited to the account's estimated average annual tax receipts. Under this proposal, total obligations for Federal-aid Highways in 1989 would be $12.6 billion--$0.9 billion below the CBO baseline and $0.4 billion below estimated 1988 obligations. The difference relative to the baseline would increase in future years, with total outlay savings of $5.9 billion over the five years.

As in previous years, the Administration proposes to eliminate all subsidies for Amtrak, reducing outlays over the five years by $3.2 billion.

Air Transportation. Aviation is targeted for significant funding increases in 1989. Most of this increase would be used to modernize and improve the air traffic control system. Under the President's budget, spending authority for Federal Aviation Administration (FAA) facilities and equipment would be increased from $1.1 billion in 1988 to $1.6 billion in 1989--a 44 percent increase--and would average $1.6 billion from 1990 through 1993. Additional funds for FAA operations would be used to hire more air traffic controllers, safety inspectors, and security personnel. The Administration proposes to derive 43 percent of the funds for FAA operations from the Airport and Airway Trust Fund in 1989, and approximately 75 percent for 1990 through 1993, compared with just over 25 percent in 1988.

Water Transportation. The President's proposals for water transportation programs would increase funding by 18 percent above the CBO baseline in 1989, resulting in additional outlays of about $0.2 billion in that year. Total additional outlays for water transportation programs would be about $1.7 billion through 1993.

Most of the increases would be for the U.S. Coast Guard (USCG), whose funding would be 14 percent above the baseline in 1989. In subsequent years, USCG operating programs would receive modest annual increases, while proposed funding for long-term acquisition and construction activities would continue to be funded at levels well above the CBO baseline.

CBO Reestimates

CBO estimates that spending under the Administration's policies would be $1.5 billion lower over the five-year period than estimated in the budget. In general, these reestimates result from different assumptions about spending rates. CBO's estimates of outlays for mass transit programs are almost $3 billion less than the Administration's over the five-year period, largely because CBO anticipates slower spending from obligated and unobligated balances.

FUNCTION 450: COMMUNITY AND REGIONAL DEVELOPMENT

PROPOSED MAJOR SPENDING CHANGES
(By fiscal year, outlays in billions of dollars)

Item	1989	1990	1991	1992	1993	Cumulative Five-Year Changes
CBO Baseline	6.7	7.1	6.9	7.1	7.4	
Proposed Changes						
Community Development Block Grants	--	-0.2	-0.4	-0.6	-0.7	-1.9
Other community development programs	--	-0.1	-0.2	-0.3	-0.4	-1.1
Rural Development Insurance Fund	-0.2	-0.1	-0.1	-0.2	-0.3	-1.0
Other regional development programs	-0.1	-0.3	-0.5	-0.8	-1.0	-2.8
Disaster programs	-0.3	-0.5	-0.2	-0.1	-0.2	-1.2
Total	-0.7	-1.2	-1.5	-2.0	-2.6	-8.1
President's 1989 Budget as Estimated by CBO a/	6.0	5.9	5.4	5.1	4.8	
President's 1989 Budget a/	6.0	6.2	5.5	5.5	5.1	
CBO Reestimates	--	-0.3	-0.2	-0.3	-0.3	-1.0

a. Excludes the Administration's proposals for credit reform; includes allowance for pay raises in 1990 through 1993.

Proposed Policy Changes

As in previous budgets, the 1989 budget proposes major reductions in spending on community and regional development. Many of the programs within this function would be eliminated, while others are slated for large reductions. Total savings relative to the CBO baseline are estimated to be $8.1 billion over the 1989-1993 period, a reduction of about 23 percent in spending in this function. The President's proposals are based on the view that many of the benefits of these programs are local in nature, and that the costs therefore should be borne locally.

Community Development. About $3.1 billion of the five-year savings relative to the CBO baseline is in community development programs, which are aimed at urban areas. The budget would reduce funding for Community Development Block Grants (CDBGs) from the 1988 appropriation of $2.88 billion to $2.63 billion annually through 1993. In addition, the President would terminate the Urban Development Action Grant (UDAG) program, beginning with a $50 million rescission in 1989 of recaptured funds. Five-year savings would total $1.9 billion for the CDBG program and $0.6 billion for UDAGs, relative to the CBO baseline. Other programs that would be terminated in 1989 are CDBG Section 108 guaranteed loans, Section 312 rehabilitation loans, and Rental Housing Development Grants (HoDAGs). The Administration is also proposing to reduce funding for Rental Rehabilitation Grants from $200 million in 1988 to $150 million in 1989 through 1993. This would result in $0.2 billion in savings from the CBO baseline over five years.

Area and Regional Development. The President's budget proposals for area and regional development programs, which are largely aimed at rural areas, would result in savings of $3.8 billion relative to the CBO baseline--a decrease from baseline levels of about 25 percent over the 1989-1993 period.

The Administration is proposing to shift activity in the Rural Development Insurance Fund (RDIF) from direct loans to guaranteed loans by phasing out direct loans and increasing loan guarantees. (Direct loans for water and waste disposal and other community facilities would be reduced from $426 million in 1988 to zero by 1992.) The limitation on loan guarantee commitments would remain constant at $96 million from 1988 to 1989, and then increase by $100 million a year through 1992. RDIF outlay savings over five years would total $1.0 billion relative to the CBO baseline.

The Administration would terminate new grant and loan activity of the Economic Development Administration and the Appalachian Regional Commission in 1989, saving $1.0 billion over five years relative to the CBO baseline. Several smaller rural development programs administered by the Farmers Home Administration would also be terminated in 1989. Another $1.0 billion in five-year outlay reductions would be obtained by cutting spending for the Bureau of Indian Affairs, Tennessee Valley Authority programs not related to power, and rural water and waste disposal grants.

Lending activities of the Rural Telephone Bank (RTB) would be limited each year to $177 million, the 1988 appropriated floor; also, beginning in 1989, the federal government would no longer purchase RTB capital stock and the RTB would set aside funds to repurchase the accumulated stock at the end of 1995. The President also proposes allowing RTB borrowers to prepay their loans without penalty beginning in 1989. CBO estimates this proposal would not result in savings until 1991, and would produce net receipts between 1991 and 1993 of about $0.5 billion.

Disaster Relief. About $1.2 billion of the five-year savings relative to the CBO baseline is achieved through disaster assistance programs. The President is proposing to sell the disaster loan portfolio of the Small Business Administration (SBA) over five years beginning in 1989. In addition, the Administration would raise the interest rate on such loans to the Treasury rate plus 1 percent, and would limit SBA disaster loans to those borrowers unable to obtain credit elsewhere. These proposals for the SBA program would result in an outlay reduction of $0.9 billion over five years relative to the CBO baseline.

Finally, the President's budget assumes that the National Flood Insurance Fund (NFIF) will be reauthorized upon its expiration on September 30, 1989. The baseline assumes expiration of the program, which would end premium income to the fund, although the insurance policies previously issued would remain in force for up to three years. The budget, like the CBO baseline, assumes premium increases of 10 percent in 1988 and 5 percent in 1989, intended to make the program actuarially sound. Reauthorization of the NFIF would result in five-year outlay savings of $0.8 billion relative to the CBO baseline.

The savings that result from the SBA and NFIF proposals are partially offset by increases in spending relative to the CBO baseline for the Federal Emergency Management Agency.

CBO Restimates

CBO estimates slightly lower outlays in each of the years from 1989 through 1993 than does the Administration. The reestimates primarily reflect lower projected disbursements from previous years' CDBG appropriations and larger prepayments of RTB loans than assumed in the budget.

FUNCTION 500: EDUCATION, TRAINING, EMPLOYMENT, AND SOCIAL SERVICES

PROPOSED MAJOR SPENDING CHANGES
(By fiscal year, outlays in billions of dollars)

Item	1989	1990	1991	1992	1993	Cumulative Five-Year Changes
CBO Baseline	35.9	37.3	38.2	39.3	39.8	
Proposed Changes						
Elementary and secondary education	-0.1	-0.2	-0.4	-0.8	-1.2	-2.6
Higher education						
Student aid	0.1	0.3	0.1	-0.2	-0.4	-0.2
Guaranteed Student Loans	-0.2	-0.3	-0.5	-0.5	-0.5	-1.8
College housing asset sales	-0.2	--	--	--	--	-0.3
Other	-0.1	-0.1	-0.2	-0.3	-0.4	-1.1
Arts and humanities	--	-0.1	-0.1	-0.2	-0.2	-0.6
Training and employment	-0.1	0.1	--	-0.1	-0.4	-0.5
Social services	-0.2	-0.4	-0.6	-0.9	-1.1	-3.2
Total	-0.8	-0.6	-1.8	-3.0	-4.1	-10.3
President's 1989 Budget as Estimated by CBO a/	35.1	36.6	36.4	36.4	35.6	
President's 1989 Budget a/	34.9	36.4	36.2	35.4	35.4	
CBO Reestimates	0.2	0.3	0.1	1.0	0.2	1.7

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a. Excludes the Administration's proposals for credit reform; includes allowance for pay raises in 1990 through 1993.

Proposed Policy Changes

Spending for job training, employment, social service, and education programs in 1989 would be $0.8 billion below CBO's baseline projection of $35.9 billion. By 1993, spending would decline by $4.1

billion, or 10 percent. In comparison with the President's most recent budgets, these reductions are modest.

Elementary and Secondary Education. In 1989, the President's budget would increase overall funding for elementary and secondary education programs by 3.6 percent over 1988, a marginal reduction from the CBO baseline projection which inflates spending in future years. The President would then freeze the 1989 request levels, lowering spending by $1.2 billion in 1993, a reduction of 10 percent. Some programs would be funded at levels above CBO's baseline in 1989, while others would be cut. As part of his reauthorization proposals for the Elementary and Secondary Education Act, the President would increase 1989 funding above the CBO baseline for programs such as Compensatory Education (Chapter 1), School Improvement (Chapter 2), Drug-Free Schools, Magnet Schools, and Adult Education. Most of the other elementary and secondary education programs would receive less than full inflation adjustments in 1989 or would be frozen at 1988 levels. Impact Aid "b" grants would again be eliminated, accounting for most of the $0.1 billion decline in 1989 outlays.

Higher Education. In sharp contrast to his 1988 budget, the President proposes to expand student grants in 1989. Offsetting this increase, spending on other higher education programs would be reduced by increasing federal collections on defaulted loans, lowering federal default cost liabilities, and reducing or freezing funding. Overall, spending would be reduced from the CBO baseline by 4 percent in 1989 and 13 percent by 1993.

Student grant funding would be increased by $555 million over the CBO baseline in 1989, raising outlays by $0.1 billion in 1989. The maximum Pell grant award would be raised by $100 to $2,300. Eligibility for Pell grants and other student aid would be expanded by excluding parents' home equity from the formula used to determine eligibility. Partially offsetting this increase would be a requirement that all recipients of federal student aid have a high school diploma. The President's 1989 funding for student grants would be frozen in 1990 through 1993, causing reduced outlays by 1992.

The President proposes the same changes in program eligibility for Guaranteed Student Loans (GSL) as for student grants. These changes would expand the number of student loans and increase the average loan size. Offsetting this increase, the Administration proposes to extend the current Internal Revenue Service (IRS) offset program that expires in June 1988. This program allows the IRS to collect and return to the program any tax refund owed to people who have defaulted on their federal student loans. Over the next five years, these collections are expected to offset GSL program costs by an estimated $1.0 billion. In addition, student loan default costs would be reduced by changing the federal liability from almost 100 percent to 80 percent; lenders and guarantee agencies would thus have to assume additional liability.

In 1989, the President proposes to sell more college housing and facilities loans. Approximately $500 million of loan assets are to be sold, with proceeds totaling an estimated $230 million.

Arts and Humanities. Arts and humanities programs, which currently account for federal spending of $1.5 billion, would be reduced below CBO's baseline by approximately 2 percent in 1989 and over 13 percent in 1993. The proposed reductions include eliminating funding for public telecommunications, reducing support for public libraries, and freezing spending at 1988 levels for public broadcasting and the federal foundations for the arts and humanities.

Training and Employment. The President's budget once again proposes to increase funding in 1989 for employment and training, but this increase is offset in later years by freezing or reducing funding levels for the current Job Training Partnership Act (JTPA) programs. As in 1988, the President's budget proposes a single discretionary program to serve dislocated workers--those who have worked for several years and whose jobs have been eliminated. This program would replace the Trade Adjustment Assistance cash benefits and training programs, and the JTPA dislocated worker program. Budget authority of $980 million--13 percent higher than the CBO baseline estimate for the existing programs--is requested in 1989. The Administration also proposes to replace the Summer Youth program with one that could be run either as a summer or as a year-round program at the discretion of localities.

Also, in 1989, the Administration would end funding of the Work Incentive program (WIN), which would be included in the Administration's proposed new work/welfare program in the Aid to Families with Dependent Children program (see function 600).

Social Services. For 1989, the President proposes only marginal reductions from the current spending level of $9.1 billion for social services; by 1993, the reduction would be 12 percent. Most of this reduction results from lower funding requests for discretionary programs. Once again, the President proposes phasing out by 1993 the Community Services Block Grant program. In 1989, funding for Head Start, a range of service programs for older Americans, and a number of child welfare programs is frozen at 1988 levels. In 1990 through 1993, funding requests for these programs grow more slowly than CBO's baseline. With the exception of proposing to reduce and eventually eliminate the cost-of-living adjustment for vocational rehabilitation grants, there are no proposed changes to entitlement programs, although the President would not reauthorize the expiring Foster Care Independent Living program.

CBO Reestimate

The CBO reestimates of the President's budget occur mainly in the GSL program. CBO projects higher interest rates than the Administration and thus higher interest subsidies in the program, which account for $0.6 billion of the reestimates in most years. Offsetting these increases are lower GSL program costs and higher estimated savings from the Administration's proposal to reduce the federal liability in the case of loan defaults.

In addition, estimated costs for interim assistance to states for the legalization of unauthorized aliens are higher in CBO's baseline, particularly in 1992, when there is an upward reestimate of $0.8 billion. Funding for costs associated with the legalization of unauthorized aliens was appropriated in the Immigration Reform Act of 1986, in the amount of $1 billion a year in 1988 through 1991. How quickly this money is spent depends on state costs associated with the aliens who are legalized. CBO estimates that such costs will grow slowly and total only $0.2 billion in 1988, leaving unspent funds available to the states in 1992. The Administration, on the other hand, estimates that the full 1988 appropriation will be spent in 1988.

FUNCTION 550: HEALTH

PROPOSED MAJOR SPENDING CHANGES
(By fiscal year, outlays in billions of dollars)

Item	1989	1990	1991	1992	1993	Cumulative Five-Year Changes
CBO Baseline	49.4	54.9	60.0	65.9	72.2	
Proposed Changes						
Medicaid	-0.4	-0.5	-0.5	-0.5	-0.6	-2.5
Public Health Service	--	-0.1	-0.3	-0.7	-1.0	-2.1
Other	--	--	-0.1	-0.1	-0.1	-0.4
Total	-0.5	-0.6	-0.9	-1.3	-1.7	-5.0
President's 1989 Budget as Estimated by CBO a/	48.9	54.3	59.1	64.6	70.5	
President's 1989 Budget a/	47.8	52.4	56.5	61.1	65.6	
CBO Reestimates	1.2	1.9	2.6	3.5	4.9	14.1

a. Excludes the Administration's proposals for credit reform; includes allowance for pay raises in 1990 through 1993.

Proposed Policy Changes

The President requests few changes in the health area, in contrast to the many cuts proposed in previous budgets. The President asked for five-year reductions of more than $25 billion in his 1987 budget and for reductions of almost $38 billion in his 1988 budget. This year's proposals would reduce health spending by less than $5 billion in the 1989-1993 period.

Medicaid. No legislative initiatives are proposed for Medicaid. The budget, however, contains regulatory changes that would reduce Medicaid outlays by $0.4 billion in 1989 and $2.5 billion through 1993. These regulatory initiatives emphasize ambulatory surgery and pre-admission testing, reduce funding for the development of Medicaid management information systems, and tighten eligibility rules pertaining to asset holdings. Most of these regulations would leave states with broad discretion as to whether and how to implement them.

Public Health Service. The Administration would slow the rate of growth in Public Health Service (PHS) funding to about 5 percent in 1989, dropping to just over 1 percent in 1990 through 1993. PHS funding has increased by 50 percent since 1983, an annual average increase of 10 percent. Slowing the growth rate would result in savings over five years of $2.1 billion below the CBO baseline. The reduction would affect most programs, with the notable exception of activities related to Acquired Immune Deficiency Syndrome (AIDS). The President requests an increase of nearly 40 percent in AIDS funding in 1989, a total of $1.3 billion. The request for AIDS funding rises to almost $1.5 billion by 1993.

The President again proposes to eliminate most grants for the education of health professionals and almost all funding for the construction of Indian health facilities. The federal government would guarantee only 80 percent of the value of Health Education Assistance Loans and would reduce new guarantees by two-thirds, which was also suggested last year. Other recurring proposals include phasing out the National Health Service Corps and selling assets in both the Health Maintenance Organization and Medical Facilities loan programs.

CBO Reestimates

CBO has reestimated the President's budget request upward by $1.2 billion in 1989 and $14.1 billion over the 1989-1993 period. Nearly all of this upward change occurs in the Medicaid program.

CBO's Medicaid baseline in 1989 is $1.5 billion higher than the Administration's estimate of current services because of differing assumptions about the underlying rate of growth in the Medicaid program, combined with the effects of recent legislation. CBO's Medicaid baseline increases by 12.1 percent from 1988 to 1989, while the Administration's increases by only 6.5 percent. Medicaid grew by 9.8 percent from 1986 to 1987 and is projected to grow by 11.2 percent from 1987 to 1988. CBO's baseline grows slightly more rapidly than in the recent past because federal legislation has expanded the number of people eligible for Medicaid and because a number of states have recently expanded their programs.

In the aggregate, CBO's estimates of savings from the President's regulatory proposals, which increase from $0.4 billion in 1989 to $0.6 billion in 1993, are similar to the Administration's estimates, which increase from $0.4 billion in 1989 to $0.8 billion in 1993.

FUNCTION 570: MEDICARE

PROPOSED MAJOR SPENDING CHANGES
(By fiscal year, outlays in billions of dollars)

Item	1989	1990	1991	1992	1993	Cumulative Five-Year Changes
CBO Baseline	87.0	98.2	109.7	122.6	136.7	
Proposed Changes						
Reduce Reimbursements to Providers						
Medical education	-1.0	-1.1	-1.2	-1.3	-1.4	-5.8
Physician payments	-0.2	-0.4	-0.4	-0.5	-0.6	-2.1
Supplier payments	-0.2	-0.3	-0.3	-0.4	-0.5	-1.7
Subtotal	-1.4	-1.7	-1.9	-2.2	-2.4	-9.6
Add to Beneficiary Costs (SMI premiums)	0.1	-0.3	-1.0	-2.0	-3.1	-6.3
Miscellaneous Proposals	0.2	0.2	0.3	0.3	0.3	1.3
Total	-1.0	-1.7	-2.7	-3.8	-5.2	-14.6
President's 1989 Budget as Estimated by CBO a/	86.0	96.4	107.0	118.8	131.4	
President's 1989 Budget a/	84.0	93.7	104.0	115.8	128.0	
CBO Reestimates	1.9	2.8	3.0	3.0	3.4	14.1

a. Includes allowance for pay raises in 1990 through 1993.

Proposed Policy Changes

The President's proposed changes in Medicare would reduce spending, relative to the CBO baseline, by $1.0 billion in 1989 and $14.6 billion over the five-year projection period. These changes would amount to a 3 percent reduction in projected Medicare spending through 1993. The Administration is proposing these further reductions because, according to its estimates, the savings from the Omnibus Budget Reconciliation Act of 1987 (OBRA-87) fell $1.2 billion short of the savings tar-

gets set at the budget summit last fall. (The differences between CBO and Administration estimates of the savings in OBRA-87 are discussed in the box below.)

BOX V-1
THE BUDGET SUMMIT AND DIFFERENCES IN CBO AND ADMINISTRATION ESTIMATES

The budget summit agreement of October 1987 set two-year savings targets for Medicare totaling $5.5 billion--$2.0 billion in 1988 and $3.5 billion in 1989. The Congressional Budget Office estimates that the Medicare provisions of the Omnibus Budget Reconciliation Act of 1987 (OBRA-87) would exceed those targets with savings of $2.1 billion in 1988 and $3.8 billion in 1989, a total of $5.9 billion. The Administration, however, estimated total savings of $4.3 billion--$1.2 billion below the targets in the budget summit agreement. Based on the apparent shortfall in savings, the Administration has included savings proposals for Medicare in its budget.

Although the estimates by CBO and the Administration differ for a number of the Medicare provisions in OBRA-87, the net effect of these individual differences is small with the exception of changes in the update factor used to increase hospital reimbursements under Medicare. OBRA-87 set specific update factors for 1988 and 1989. CBO estimated savings of $1.7 billion from these update factors; the Administration's estimate was $0.4 billion. The $1.3 billion difference is explained by differences in the base from which the savings were calculated. CBO assumed that without legislative action the update factors would have been increased in 1989 by the increase in an index of the costs of goods and services used by hospitals, but the Administration assumed that the update would be only one-half of this increase. Since CBO's base contained a larger increase than the Administration's, CBO's estimate of savings from limiting the increase was larger.

The budget summit set savings targets for Medicare, but did not determine the base from which these savings were to be measured, creating an irreconcilable difference between the CBO and Administration estimates for 1988 and 1989. Because OBRA-87 set hospital updates at the total increase in the index of costs of hospitals' goods and services beginning in 1990, this difference in the base should not arise in the future for the update factor. Other differences in the base, however, could cause the CBO and Administration estimates to differ.

Reducing Reimbursements to Providers. The President's budget includes several proposals to reduce reimbursements to providers. Relative to CBO's baseline, these proposals would reduce outlays by $9.6 billion over the next five years.

The budget includes five-year savings of $5.8 billion that would result from lowering reimbursement for the direct and indirect costs of medical education in hospitals with teaching programs. Direct costs of medical education include payments for residents' and teachers' salaries, classroom expenses, and associated overhead. The proposed change in direct payments would reduce the expenses that a hospital could claim by excluding all classroom-related education costs of intern and residency programs. This change would save an estimated $60 million in 1989 and $440 million over the projection period, according to both CBO and the Administration. Indirect payments compensate for the costs of the greater number of tests and procedures prescribed by interns and residents. Hospitals are compensated through an adjustment in their prospective payments based on the ratio of interns and residents to the number of beds in the hospital. The President's proposal, as estimated by CBO, would reduce the current indirect teaching adjustment from 7.70 percent to 4.05 percent for each 0.1 percentage point in the ratio, saving an estimated $900 million in 1989 and $5.3 billion over the five-year period relative to the CBO baseline. The Administration's comparable estimates are $920 million in 1989 and $6.8 billion over the next five years.

The President's budget proposes to reduce reimbursements for selected physician services and for certain categories of durable medical equipment and supplies. CBO estimates that this change would save about $3.8 billion over the five-year projection period; the Administration estimate is $3.5 billion. Many of these proposals reflect the deeper cuts the Administration supported during the conference on OBRA-87.

The Administration continues to target certain physician services that have been identified by the Physician Payment Review Commission as overpriced. In OBRA-87, payments for all overpriced procedures were reduced by 2 percent. The law also reduced, on a sliding-scale basis, charges that are above 85 percent of the national average prevailing charge for the overpriced procedures. The President's budget proposes a further reduction of 5 percent in payments for all such procedures, saving an estimated $53 million in 1989 and $505 million through 1993. The Administration's comparable estimates are $25 million and $360 million. In addition, OBRA-87 requires the Secretary of Health and Human Services to establish fee schedules for radiologists and anesthesiologists by January 1, 1989. The Administration proposes to delay implementation of these fee schedules for one year and to reduce payments to radiologists and anesthesiologists by 10 percent in 1989. The reduced payment levels would then be used as the basis for the fee schedule established in 1990. CBO estimates this proposal would save $156 million in 1989 and $1.5 billion over the five-year projection period. Administration estimates are $105 million and $1.2 billion, respectively. A minor proposal affecting physician reimbursement would save about $95 million over five years.

Beginning in 1989, durable medical equipment and oxygen supplies will be reimbursed according to a fee schedule established by OBRA-87. The fee schedule for long-term rental items will be based on charges submitted by suppliers for 1986, increased by the Consumer Price Index (CPI). The President's budget proposes instead to base the fee schedule on the amount Medicare "allowed" for the item in 1986 increased by the CPI. Because of the difference between submitted and Medicare-allowed charges, CBO estimates this proposal would save $95 million in 1989 and $855 million over five years. The Administration estimates savings of $80 million and $720 million. In addition, payments for oxygen equipment and supplies were reduced 5 percent by OBRA-87; the Administration proposes a further reduction of 5 percent, which CBO estimates could save $20 million in 1989 and $185 million over five years, with similar savings estimated by the Administration.

Medical suppliers' payments under Medicare would be further reduced by two other proposals in the President's budget. One proposal, which would limit reimbursement to suppliers of home dialysis products to the same rate received by dialysis treatment facilities, would save an estimated $55 million in 1989 and $585 million through 1993. Administration estimates are similar for this proposal. The other proposal would reduce reimbursement to suppliers of enteral products and equipment by establishing a national fee schedule based on wholesale and retail prices, saving about $20 million in 1989 and $120 million over the next five years. The Administration estimates savings of $25 million in 1989 and $245 million through 1993.

Adding to Beneficiary Costs. Under current law, premiums will be set at 25 percent of program costs through 1989 and will increase by the Social Security cost-of-living adjustment (COLA) in future years. According to CBO estimates, Supplementary Medical Insurance (SMI) spending will increase faster than the COLA, so that beneficiary premiums will decline over time as a proportion of program costs. By 1993, estimated premiums will cover only 20 percent of program costs. Under the budget proposal, enrollees would pay a premium based on 25 percent of annual program costs, thereby generating additional offsetting receipts of $6.9 billion over the projection period, according to CBO estimates. The Administration projects $6.7 billion in additional offsetting receipts for the same period. The table below shows the monthly premiums as estimated by CBO and the Administration; the estimates for the President's budget reflect savings from the budget's other Medicare proposals.

Estimated Monthly Premiums
(By calendar year, in dollars)

	1989	1990	1991	1992	1993
CBO Baseline	27.10	28.30	29.70	31.00	32.40
Administration (Current law)	28.00	29.20	30.40	31.50	32.50
President's 1989 Budget as Estimated by CBO	26.70	29.30	32.80	36.50	40.70
President's 1989 Budget	27.70	30.50	34.00	36.70	41.20

Miscellaneous Proposals. Other proposals in the budget would cost $1.3 billion over the projection period. The Administration has requested about $250 million per year to increase budgets for contractors who process Medicare claims. Medicare outlays would also increase by $55 million through 1993 because the President proposes to include state and local employees hired before March 31, 1986, in the Medicare program. The revenue estimates for this proposal are discussed in Chapter III. The President also proposes to save $66 million over five years by increasing the effectiveness of recently enacted legislation that makes Medicare the secondary payer for the working elderly and disabled and their dependents who elect to take advantage of employer-provided health insurance.

The 1989 budget estimates do not reflect any reform in catastrophic health insurance, but the Administration supports the enactment of legislation on such insurance, consistent with the provisions of the Senate-passed Medicare Catastrophic Protection Act (H.R. 2470). The major provisions of that bill would limit beneficiaries' out-of-pocket expenses for hospital and physician copayments to $2,030 in 1989; phase in a benefit beginning in 1990 that would cover 80 percent of reasonable costs of certain prescription drugs above a $600 deductible; provide unlimited coverage of inpatient hospital stays and expand benefits for home health care and skilled-nursing facilities; and finance the new benefits with an additional flat monthly premium as well as a supplemental income-related premium on SMI enrollees who have an income tax liability of $150 or more. Conference on the Senate- and House-passed versions of H.R. 2470 is expected this spring.

CBO Reestimates

CBO reestimates raise the President's Medicare budget by $1.9 billion in 1989 and by $3.4 billion in 1993. These differences represent about 2 percent and 3 percent, respectively, of total Medicare spending in the President's budget in those years. About one-half of the difference in the estimates results from different economic assumptions. The Administration's lower projected inflation rates lead to lower projected price increases for hospital and physician services, and the lower projected COLA for Social Security reduces their estimated premium receipts. The remaining differences result from different technical assumptions concerning underlying growth rates in the medical sector.

FUNCTION 600: INCOME SECURITY

PROPOSED MAJOR SPENDING CHANGES
(By fiscal year, outlays in billions of dollars)

Item	1989	1990	1991	1992	1993	Cumulative Five-Year Changes
CBO Baseline	139.0	147.1	155.2	163.3	173.3	
Proposed Changes						
Family support payments	0.2	0.3	0.3	0.4	0.5	1.7
Low-income energy assistance	-0.4	-0.5	-0.5	-0.6	-0.7	-2.6
Housing assistance	--	--	-0.1	-0.1	-0.2	-0.3
Nutrition	-0.1	-0.1	-0.1	-0.2	-0.3	-0.7
Trade Adjustment Assistance	-0.1	-0.1	-0.1	-0.1	-0.1	-0.5
Other	-0.1	-0.2	-0.2	-0.3	-0.4	-1.2
Total	-0.3	-0.5	-0.8	-1.0	-1.1	-3.8
President's 1989 Budget as Estimated by CBO a/	138.7	146.6	154.4	162.3	172.2	
President's 1989 Budget a/	135.6	140.6	146.5	152.3	158.0	
CBO Reestimates	3.1	6.1	7.9	10.0	14.1	41.1

a. Includes allowance for pay raises in 1990 through 1993.

Proposed Policy Changes

The President's proposals would reduce outlays for income security programs $3.8 billion, or 0.5 percent, below the CBO baseline over the 1989-1993 period. Past budgets have proposed much larger reductions, generally of more than $30 billion. The budget differs from past budgets by proposing no changes in retirement and disability benefits, Food Stamps, and the Pension Benefit Guaranty Corporation. The major proposals in this function are the Administration's welfare reform proposal, which CBO estimates will result in increased outlays, and a proposal to reduce funding for the Low-Income Home Energy Assistance Program (LIHEAP).

Family Support Payments to States. The President has adopted the Republican-sponsored welfare reform bills--H.R. 3200 and S. 1655--as his legislative proposal in the Aid to Families with Dependent Children (AFDC) and Child Support Enforcement (CSE) programs. The proposal would require many AFDC recipients to participate in education, work, or training programs; mandate the states to make a number of improvements in their CSE programs, such as using guidelines to set amounts of child support orders and requiring child support payments by absent parents to be withheld from their paychecks; require a minor mother to live with her mother; and expand waivers that would allow the states to modify their programs for low-income families. The proposal differs significantly from the welfare reform bill passed by the House (H.R. 1720). That bill expands the AFDC program by mandating the AFDC-Unemployed Parent program in all states, by increasing the allowable deductions from earnings, and by raising the federal match rate for increases in payments made by states. The bill also includes many of the same changes in the CSE program as the President's proposal, as well as a work-related program for AFDC recipients.

The total cost of the President's proposal over five years is estimated by CBO to reach $0.9 billion, whereas the Administration estimates savings of $0.2 billion. (These estimates include the effects of the President's proposal on all affected programs, even those in other budget functions, as shown in the following table.) While CBO shows higher savings for the CSE reforms, much higher costs are shown for the AFDC program requiring many benefit recipients to work or train. The President's work-related proposal authorizes $500 million in 1989 and such sums as are necessary thereafter (replacing Work Incentive (WIN) program funding and open-ended spending in AFDC on work programs); requires states to meet participation rate standards that rise from 15 percent of recipients required to register for work programs in 1989, to 30 percent in 1993, and to 70 percent in 1997 and beyond; requires registration for families with children over the age of six months not otherwise excused; and matches state spending--including spending on education and training--at existing average rates.

COST AND SAVINGS OF WELFARE REFORM, 1989-1993
(Five-year changes in outlays, in billions of dollars)

	CBO	Administration
Total Cost (+) or Savings (-)	0.9	-0.2
AFDC Work-Related Programs		
Costs		
New program	3.1	2.6
Existing AFDC work programs	-0.7	-0.6
Existing WIN programs (Function 500)	-0.5	-0.5
Total	1.9	1.4
Savings		
AFDC and Food Stamps	-0.3	-0.9
Medicaid (Function 550) a/	-0.1	-0.5
Total	-0.3	-1.3
Net Cost	1.6	0.1
Other Provisions		
Savings		
AFDC, CSE, and Food Stamps	-0.5	-0.3
Medicaid (Function 550) a/	-0.2	--
Net Savings	-0.6	-0.3
Costs or Savings by Budget Function		
Function 500	-0.5	-0.5
Function 550	-0.2	-0.5
Function 600	1.7	0.8

a. In the President's budget, Medicaid savings are shown in function 600.

For the work-related program, estimated federal costs are $1.9 billion over five years, while estimated federal savings as families leave welfare or have their welfare benefits reduced as a result of the work program are only $0.3 billion. Costs are reduced by ending WIN funding and existing spending on work programs in AFDC; savings include those in the AFDC, Food Stamp, and Medicaid programs. The Administration shows somewhat lower costs--$1.4 billion--but markedly higher savings--$1.3 billion. According to the Administration, the work program shows net savings by 1992, even though participation rates, and therefore costs, are rising throughout the 1989-1993 period. Usually, savings lag spending on work programs and build up only gradually.

The CBO estimates are based in general on the recent studies of AFDC work programs in Arkansas, California, Maryland, and Virginia undertaken by the Manpower Demonstration Research Corporation. Nonetheless, estimated effects of the work proposal are very uncertain. The proposal's required participation rates would result in 600,000 full-year participants in 1993, or 2.4 million participants in a three-month program, which would be more in line with current lengths of stay in state work programs. The three-month program by 1993 would therefore include 60 percent of the 3.9 million families on the program in any month. To accommodate this many participants, states would probably reduce their spending for each participant significantly, but the exact amount of such a reduction is uncertain. As spending per participant declined and participants were recycled through work programs, welfare savings would also decline, but by an uncertain amount.

Low-Income Home Energy Assistance Program. The Administration requests $1.2 billion for the Low-Income Home Energy Assistance Program in 1989 and in subsequent years. This funding level is $0.3 billion below the 1988 appropriation and $0.4 billion below the CBO baseline for 1989. The total outlay savings relative to the CBO baseline for 1989 through 1993 are $2.6 billion, a 30 percent reduction.

The Administration expects that states will use funds from oil overcharge settlements to supplement the decreased federal funding of LIHEAP. To date states have received $3.3 billion in oil overcharge settlements, and they may expect to receive an estimated $1.3 billion in additional settlements. States may distribute these oil overcharge funds among LIHEAP and other energy-related programs. They have allocated over half of the money received so far and given LIHEAP less than 20 percent of these funds. LIHEAP has already spent $0.2 billion of its allocated money to supplement federal LIHEAP funding. If states continued to allocate and spend the remaining oil overcharge funds as they have in the past, they would fall short of supplementing the five-year $2.6 billion reduction by more than $2 billion. In addition, the distribution of oil overcharge settlements to the states is determined by the courts and can differ significantly from the federal distribution to states of LIHEAP funds. If LIHEAP funds were distributed in the same manner as past oil overcharge settlements, some states' grants would increase by 100 percent while others would decrease by over 33 percent.

Housing Assistance. The President has requested $8 billion in budget authority for 1989 to fund the Department of Housing and Urban Development's (HUD) low-income rental assistance programs, a $1.5 billion cut from the CBO baseline for 1989. Once again, the Administration proposes to provide five-year vouchers rather than the more traditional fifteen- to twenty-year rental assistance contracts. The shift to shorter-term vouchers would allow assistance for an estimated 108,000 additional households, including 100,000 vouchers, 7,000 rental units for the elderly and handicapped, and 1,000 Indian public housing units. The CBO baseline assumes the continuation of 1988 appropriations and program mixes and includes funding for about 76,000 additional units, including 45,000 vouchers, 11,000 units for the elderly and handicapped, and about 4,800 public housing units. The President's proposal would save $0.8 billion in outlays from 1989 through 1993.

The budget proposals would radically change the provision of low-income housing assistance in rural areas. Direct federal housing loans would be replaced with a voucher system based on the system currently operated by HUD. In addition, the President would terminate funding for four smaller rural housing programs. These proposals would add a five-year total of $0.5 billion to function 600 outlays, but these costs would be more than offset in function 370.

Nutrition. The President's proposal would reduce funding for the Emergency Food and Shelter program to one-third below the CBO baseline, saving $0.2 billion over five years. This program provides grants to voluntary organizations that assist the homeless. The budget also proposes freezing funding for Nutrition Assistance for Puerto Rico in 1990 through 1993, saving a total of $0.2 billion relative to CBO's baseline. An additional $0.3 billion reduction is proposed for nutrition programs intended for the elderly, Indians, women, infants, and children.

Trade Adjustment Assistance. The President again proposes eliminating the Trade Adjustment Assistance program for workers who lose their jobs because of import competition. The proposal would save an estimated $0.5 billion from 1989 through 1993. The Administration requests funding for a new and comprehensive program to provide training services for dislocated workers and other workers. Funds for this new program are included in function 500 (Education).

Other. The President's request for Refugee Assistance in 1989 is 20 percent below the 1988 appropriation and would reduce outlays $0.5 billion below the CBO baseline through 1993. The President's requests for administrative funds for several programs are also below the CBO baseline. Finally, the budget discusses a proposal to privatize the Railroad Retirement pension plan, but the proposal is not reflected in the budget accounts and its details are not yet specified.

CBO Reestimates

CBO reestimates raise the President's budget by $41 billion over the five-year period. Nearly one-half of the reestimates reflect different economic assumptions--mainly CBO's assumption of greater cost-of-living adjustments and higher unemployment rates. Technical reestimates total $21 billion over the projection period, or 51 percent of the total CBO reestimates.

The largest technical reestimate--totaling $5.5 billion over the five-year period--occurs in the Family Support Payments to States account, which includes the AFDC and CSE programs. About three-quarters of the technical reestimate comes from differences in current service baselines, and one-quarter from differences in estimates of legislative proposals.

Most of the reestimate of Family Support Payments reflects different assumptions about the rate at which states will increase AFDC benefit payments. CBO assumes that benefits per family will rise at an average annual rate of 3.5 percent, which is lower than increases in most recent years but higher than the increase in 1987. The Administration uses a rule of thumb that ties benefit increases to a portion of the rise in the consumer price index (CPI). When the CPI is rising at a modest rate, as in the projected period, the estimated rise in benefit payments is quite low. In addition, CBO estimates that the federal government will collect fewer of the fiscal sanctions that are levied on the states for errors in excess of 3 percent in AFDC benefit payments.

Fiscal sanction collections are less than the Administration's because collections are assumed to begin only in 1990 and because only two-thirds of sanctions are assumed to be collected as a result of legal review.

The reestimate of legislative savings is primarily for the Administration's proposed work requirement for AFDC recipients, as discussed earlier.

The second major technical reestimate is a $5.1 billion, five-year increase in unemployment compensation, which represents a 6 percent increase over the Administration's estimate of unemployment outlays through 1993. The CBO estimate is higher because CBO projects that more people will receive benefits, and that the average period covered by these benefits will be longer.

CBO's reestimate of the refundable portion of the Earned Income Tax Credit (EITC), counted as a budget outlay, adds $3.0 billion to spending over the 1989-1993 period. Most of this difference is offset in the revenue estimates, which assume a smaller credit against taxes owed. CBO's reestimate for the entire EITC is $0.9 billion higher than the Administration's estimate over the 1989-1993 period. Remaining technical reestimates total $7.2 billion over the five-year period, and are distributed among several entitlement programs.

FUNCTION 650: SOCIAL SECURITY

PROPOSED MAJOR SPENDING CHANGES
(By fiscal year, outlays in billions of dollars)

Item	1989	1990	1991	1992	1993	Cumulative Five-Year Changes
CBO Baseline	234.0	251.3	268.3	285.4	302.8	
Proposed Changes	--	-0.2	-0.3	-0.4	-0.5	-1.4
President's 1989 Budget as Estimated by CBO a/	234.0	251.1	268.0	285.0	302.3	
President's 1989 Budget a/	233.8	248.5	263.5	277.3	290.5	
CBO Reestimates	0.2	2.6	4.5	7.8	11.8	26.9

a. Includes allowance for pay raises in 1990 through 1993.

Proposed Policy Changes

The Administration proposes no changes in Social Security benefits and revenues, but requests a 7.1 percent increase in the limitation on administrative expenses (LAE) for the Social Security Administration for 1989. The budget maintains the LAE at its 1989 level through 1993. Five-year savings total $1.4 billion relative to CBO's baseline, although some of this difference is artificial. When the administrative expenses in the Supplemental Security Income program are included (they are also included under the Social Security Administration's LAE, but are reflected in function 600), the Administration's request nearly equals CBO baseline in 1989 and is $0.8 billion lower between 1990 and 1993.

CBO Reestimates

CBO has reestimated the President's budget request upward by a total of $26.9 billion over the next five years. The use of CBO's economic assumptions raises estimated outlays, while technical reestimates generally reduce outlays. The economic reestimates relate to differences in cost-of-living adjustments (COLAs). CBO's projected COLAs remain in the 4 percent to 5 percent range through 1993, compared with the Administration's projection of decreasing COLAs. These differences in COLA assumptions cause significant reestimates of the President's budget because an increase of one percentage point in the COLA would raise Social Security spending for calendar year 1989 by $2.2 billion. (An additional $0.8 billion would result in other programs such as Veterans Compensation and Pensions, Supplemental Security Income, and Military and Civilian Retirement.)

Social Security Cost-of-Living Adjustments
Assumed by CBO and the Administration
(In percents)

	1989	1990	1991	1992	1993
CBO	4.5	4.9	4.6	4.4	4.4
Administration	4.2	4.0	3.6	3.1	2.6

CBO's technical reestimates decrease projected spending in the Old-Age and Survivors Insurance (OASI) program, but increase spending in the Disability Insurance (DI) program. The growth in OASI spending is lower because of smaller retroactive benefit payments, lower real wage growth that in turn leads to smaller average OASI benefits for new beneficiaries, and smaller increases in the number of elderly beneficiaries. On the other hand, DI spending increases more rapidly because of the greater number of people receiving disability benefits, although the difference between the CBO and Administration estimates narrows somewhat after 1991. The combined OASI and DI technical reestimates reduce projected Social Security costs by $2.0 billion over the next five years.

FUNCTION 700: VETERANS BENEFITS AND SERVICES

PROPOSED MAJOR SPENDING CHANGES
(By fiscal year, outlays in billions of dollars)

Item	1989	1990	1991	1992	1993	Cumulative Five-Year Changes
CBO Baseline	28.6	30.3	31.0	31.9	32.8	
Proposed Changes						
Loan guaranty						
Origination fee	0	-0.2	-0.3	-0.3	-0.3	-1.1
Loan sales	-0.2	-1.0	-0.5	-0.4	-0.4	-2.5
Medical care	-0.3	-0.3	-0.3	-0.3	-0.4	-1.5
Other	--	-0.1	-0.1	-0.1	-0.1	-0.5
Total	-0.5	-1.5	-1.2	-1.2	-1.2	-5.7
President's 1989 Budget as Estimated by CBO a/	28.1	28.8	29.9	30.7	31.5	
President's 1989 Budget a/	28.7	29.7	30.5	31.3	31.9	
CBO Reestimates	-0.6	-0.9	-0.6	-0.6	-0.4	-3.2

a. Excludes the Administration's proposals for credit reform; includes allowance for pay raises in 1990 through 1993.

Proposed Policy Changes

The changes proposed in the President's 1989 budget for veterans' benefits and services are minor, except for changes in the home loan guaranty program and in medical care services for veterans.

Loan Guaranty Revolving Fund. The President's 1989 budget assumes an extension of the authority of the Veterans Administration (VA) to charge a fee of 1 percent of the mortgage principal on all guaranteed and direct loans made under the VA's home loan guaranty program. Under current law, this authority will expire after September 30, 1989. CBO estimates that collections of these fees would offset the fund's outlays by $225 million in 1990, increasing to $295 million in 1993.

Before 1988, the VA routinely sold direct loans held by the revolving fund with full recourse to the government in the event of default. Beginning in 1989, the Office of Management and Budget will no longer allow agencies to offer recourse provisions on loan sales. Under the provisions of Public Law 100-136 and Public Law 100-198, the VA can sell loans without recourse in 1988 and 1989, but will be required to resume offering recourse on sales occurring after September 30, 1989. The President's budget assumes that the law will be amended to allow the continuation of nonrecourse sales through 1993.

The budget also proposes to sell all loans in the VA's portfolio of direct loans. The routine sales of direct loans discussed above involve recently closed loans for which payments are current. The loans held in the portfolio previously have been considered unavailable for sale because of poor documentation or delinquencies, or because the loan is old and carries a low interest rate. Even though the sale of the portfolio would not require Congressional action, it is a significant policy change and therefore is not included in the CBO baseline.

Medical Care. The appropriations requested in the President's budget for 1989 through 1993 are nearly $1.7 billion lower than the budget authority projected in the CBO baseline. The CBO baseline reflects inflation and pay increases that are calculated according to the formula specified by Public Law 100-119, the Balanced Budget Reaffirmation Act. The President's request appears to assume that some of these inflationary increases will be absorbed, but does not specify how the costs will be offset.

Compensation. The compensation program is not indexed by law, but historically its benefits have been increased for inflation each year through legislation. The President's budget proposes to index the benefits permanently. Because the CBO baseline includes these outyear inflation increases as specified in the Balanced Budget Act, the President's proposal has no cost relative to the baseline.

Other. The President's budget contains several other legislative proposals with minor budgetary effects. The Administration proposes to restrict the payment of burial plot allowances to the survivors of veterans with service-connected disabilities or low incomes, thereby saving about $26 million a year. The authority for loans from the Education Loan Fund would be repealed, but the effect of this change would be minimal because fewer than 20 loans are expected in 1989 and later years. Proposals for the VA Medical Care program include an increase in per diem payments to state homes as well as expanded authority to reimburse nurses for tuition expenses. These two changes would cost approximately $23 million a year.

CBO Reestimates

There are two major technical reestimates of 1988 spending: CBO assumes that supplemental appropriations will be required to cover the cost-of-living adjustment (COLA) in the compensation program and higher-than-anticipated costs in the Loan Guaranty Revolving Fund. The President's budget shows deficits for 1988 in both of these accounts, but does not request supplementals to cover them.

In 1989 through 1993, the President assumes significantly lower COLAs for the compensation and pensions programs than are reflected in the CBO baseline (see function 650). Under CBO economic assumptions, outlays from these programs would be $1.6 billion higher through 1993 than under the Administration's assumptions. In addition to the economic difference, CBO's outlay estimate for the pensions program is approximately $1.5 billion below the President's estimates for 1989 through 1993. CBO's analysis indicates that the caseload of the pension program established by Public Law 95-588 should peak in the near future and then begin to decline, whereas the Administration is projecting a continued increase.

CBO also anticipates lower participation and training rates under the Montgomery GI Bill (formerly known as the New GI Bill), which account for a downward reestimate of $0.9 billion over five years in the readjustment benefits account, the Education Benefits Fund, and Department of Defense contributions. Finally, an expectation of lower default rates than assumed by the VA causes the CBO estimate of spending from the Loan Guaranty Revolving Fund to be about $1.6 billion below VA estimates through 1993.

FUNCTION 750: ADMINISTRATION OF JUSTICE

PROPOSED MAJOR SPENDING CHANGES
(By fiscal year, outlays in billions of dollars)

Item	1989	1990	1991	1992	1993	Cumulative Five-Year Changes
CBO Baseline	8.5	8.9	10.0	10.5	10.9	
Proposed Changes						
Federal prison system	0.2	0.4	0.5	0.6	0.7	2.4
The Judiciary	0.3	0.3	0.4	0.4	0.5	1.9
Customs user fees	0.8	0.8	--	0	0	1.7
Office of Justice Programs	-0.1	-0.1	-0.2	-0.2	-0.2	-0.7
Other	0.1	0.1	0.1	--	-0.2	--
Total	1.3	1.5	0.8	0.9	0.8	5.3
President's 1989 Budget as Estimated by CBO a/	9.8	10.4	10.9	11.3	11.7	
President's 1989 Budget a/	9.9	10.5	10.8	11.3	11.7	
CBO Reestimates	-0.1	-0.1	--	0.1	0.1	--

a. Includes allowance for pay raises in 1990 through 1993.

Proposed Policy Changes

The President's proposed spending levels for administration of justice are $3.6 billion (8 percent) higher than the CBO baseline for the 1989-1993 period. The increase results from higher spending for prisons and judicial activities, which is partially offset by reductions for justice assistance and law enforcement. In addition, the Administration is proposing to reclassify certain customs fees as revenues, which would have the effect of increasing both outlays and revenues by a total of $1.7 billion over the 1989-1991 period.

Federal Prison System. The largest spending increase in this function is for federal prisons. The President's proposal would raise spending on the federal prison system by almost $2.4 billion, or 46 percent, above the CBO baseline from 1989 through 1993. Under the President's budget, spending authority for buildings and facilities in the federal prison system would be increased from $202 million in 1988 to $437 million in 1989, an increase of 116 percent. Most of this increase would be for construction of new prisons and the expansion and renovation of existing facilities. Spending authority for the entire federal prison system would be increased by about 50 percent in 1989.

The Judiciary. Spending by the Judiciary would be approximately $1.9 billion, or about 25 percent, above the baseline level from 1989 through 1993. The budget proposes a major increase in spending authority in 1989, and would increase spending at close to the baseline rate of growth in subsequent years. Most of this increase would be for the courts of appeals, district courts, and other judicial services.

Customs User Fees. Under legislation to be transmitted, the President's budget would reclassify the ad valorem tax portion of customs user fees (commonly known as OBRA fees) as revenues. Currently, these fees are classified as offsetting receipts under the requirements of the Budget Reconciliation Act of 1987 (Public Law 100-203). Because of this reclassification, spending levels in the President's budget are $1.7 billion higher than the baseline.

Office of Justice Programs. Once again, the President proposes to terminate several programs within the Department of Justice's Office of Justice Programs (OJP), including the Office of Juvenile Justice and Delinquency Prevention and the state and local drug grants. These terminations would result in spending levels for OJP that total $700 million less than the baseline from 1989 through 1993.

Other. Spending on law enforcement activities would decline under the President's proposals by $314 million relative to the CBO baseline from 1989 through 1993. Spending is roughly equal to the baseline in 1989, 1990, and 1991, but declines thereafter, falling $195 million (3 percent) below the baseline by 1993. Spending for the Immigration and Naturalization Service is above the baseline each year, while spending for the Drug Enforcement Administration and the Federal Bureau of Investigation increases for 1989 and 1990 but falls below the baseline in subsequent years. Spending for law enforcement programs in the Treasury Department, including the Customs Service and the Secret Service, is below the baseline each year. The President's budget also assumes reauthorization of the Crime Victims Fund, which would otherwise expire after 1989.

CBO Reestimates

The CBO reestimate of the President's budget displays the passenger fee portion of customs user fees (commonly known as COBRA fees) as offsetting receipts, while the President's budget displays them as revenues.

FUNCTION 800: GENERAL GOVERNMENT

PROPOSED MAJOR SPENDING CHANGES
(By fiscal year, outlays in billions of dollars)

Item	1989	1990	1991	1992	1993	Cumulative Five-Year Changes
CBO Baseline	9.8	10.7	10.7	10.8	11.1	
Proposed Changes						
Payments to states and counties	--	-0.3	-0.3	-0.3	-0.3	-1.2
Payments to the District of Columbia	-0.1	-0.1	-0.1	-0.2	-0.2	-0.7
Federal Buildings Fund	-0.1	0.2	0.2	0.3	0.5	1.1
Other	0.1	0.2	0.1	0.1	--	0.5
Total	-0.1	--	-0.1	-0.1	--	-0.3
President's 1989 Budget as Estimated by CBO a/	9.7	10.7	10.6	10.7	11.1	
President's 1989 Budget a/	9.5	10.4	10.3	10.3	10.8	
CBO Reestimates	0.2	0.3	0.2	0.4	0.3	1.5

a. Includes allowance for pay raises in 1990 through 1993.

Proposed Policy Changes

The President's budget includes funding for general government activities that would result in outlays $0.3 billion below the CBO baseline over the 1989-1993 period. The largest savings would be from changes in payments to states and counties from federal mineral and timber receipts. States' and counties' share of such receipts is calculated currently as a percentage of gross, not net, receipts. These shares vary from program to program, but most are between 25 percent and 50 percent. The President proposes to reduce the amount of such receipts distributed to state and local governments by calculating their share after deducting collection costs. CBO estimates that this proposal would result in savings to the federal government of about $0.3 billion per year, and five-year savings of $1.2 billion by 1993.

The budget request for payments to the District of Columbia is below the CBO baseline in each year, dropping from the $550 million provided in 1988 to $485 million by 1993. The 1989 request of $525 million would hold basic assistance payments to their 1988 level of $431 million and would provide funding for retirement contributions, St. Elizabeth's Hospital transfer payments, and inauguration expenses at levels authorized under current law. No specific request has been included for compensation for federal use of the District's water and sewers. The President's budget would result in payments to the District that are $0.7 billion below the baseline through 1993.

These decreases are largely offset by proposed increases in spending in other areas. The President proposes to increase spending from the Federal Buildings Fund for building construction, acquisition, and repair projects. Additional spending for these activities would exceed the baseline by $1.1 billion over the five-year period. Outlays for the legislative branch and for other general government activities would also be above the baseline, by about $0.5 billion over the 1989-1993 period. Finally, the President proposes to continue funding for new Internal Revenue Service (IRS) employees hired during 1988. IRS outlays would be approximately at baseline levels over the five years.

CBO Reestimates

The budget assumes that additional efforts to identify and sell surplus federal property would raise about $0.7 billion through 1993. Past attempts by the Administration to sell property fell substantially short of stated goals, and the lengthy process of declaring property as surplus makes drastic increases in the inventory of salable surplus property unlikely. CBO therefore estimates that surplus property sales will remain at recent historical levels, resulting in higher net outlays for the function than were estimated in the budget. CBO's estimate of outlays for a number of other programs, based on historical spending patterns, is also higher than in the budget.

FUNCTION 900: NET INTEREST

PROPOSED MAJOR SPENDING CHANGES
(By fiscal year, outlays in billions of dollars)

Item	1989	1990	1991	1992	1993	Cumulative Five-Year Changes
CBO Baseline	165.9	184.8	197.9	203.4	208.1	
Proposed Changes						
Interest on the public debt	-0.5	-1.6	-2.8	-4.4	-6.3	-15.6
Education bonds	--	-0.1	-0.1	-0.2	-0.3	-0.7
Other interest	0.3	0.6	0.9	1.1	1.5	4.4
Total	-0.2	-1.1	-2.1	-3.5	-5.0	-11.9
President's 1989 Budget as Estimated by CBO	165.7	183.7	195.8	199.9	203.1	
President's 1989 Budget	151.6	156.1	158.8	151.0	141.5	
CBO Reestimates	14.1	27.6	37.0	48.9	61.5	189.1

Proposed Policy Changes

The Administration's spending and revenue proposals lead to smaller deficits than contained in the CBO baseline projections, and reduce the government's need to borrow. Under the Administration's deficit reduction program, debt held by the public is $11 billion lower than the baseline at the end of 1989, and $95 billion lower at the end of 1993. The resulting savings in debt service--small at first--grow to $6 billion by 1993.

Small savings in interest costs stem from the Administration's proposal to allow tax-exempt savings for education (see Chapter III). The government's interest expense would decrease, since the proposal would boost the demand for savings bonds and lessen the need to sell marketable securities at higher interest rates. The net effect of this proposal, however, is to increase the deficit, since the expected revenue loss exceeds the small savings in net interest.

Additional proposals in the Administration's budget reduce the government's interest receipts by $290 million in 1989, $560 million in 1990, and $1.5 billion in 1993. These interest reductions stem from proposals that reduce lending levels for certain federal programs, such as the Farmers Home Administration and the Small Business Administration; waive penalties due the Federal Financing Bank when certain loans made by the Farmers Home Administration are prepaid; and require sales of loan assets from agency portfolios.

CBO Reestimates

Reestimates of the Administration's net interest spending total $14.1 billion in 1989, $27.6 billion in 1990, and $61.5 billion in 1993. These differences arise chiefly from higher interest rates and higher deficits assumed by CBO. Other technical estimating differences are small.

CBO's assumption of higher interest rates leads to a $133 billion reestimate of the President's net interest outlays over the five-year period. These reestimates grow from $12 billion in 1989, when CBO short-term interest rate projections are 1.3 percentage points above the Administration's projections and longer-term projections are 2.1 percentage points higher, to $41 billion in 1993, when the interest rate differentials are 2.2 percentage points and 3.0 percentage points higher, respectively.

Another $60 billion in reestimates over the five-year period results from higher deficits than contained in the President's budget. Because of other reestimates to revenues and outlays, CBO projects that the federal government's borrowing needs would be higher than forecast by the Administration. Additional interest costs from this borrowing grow from $3 billion in 1989 to $22 billion in 1993.

FUNCTION 920: ALLOWANCES

PROPOSED MAJOR SPENDING CHANGES
(By fiscal year, outlays in billions of dollars)

Item	1989	1990	1991	1992	1993	Cumulative Five-Year Changes
CBO Baseline	0	0	0	0	0	
Proposed Changes	--	--	-0.1	-0.1	-0.1	-0.2
President's 1989 Budget as Estimated by CBO a/	--	--	-0.1	-0.1	-0.1	
President's 1989 Budget a/	--	--	-0.1	-0.1	-0.1	
CBO Reestimates	0	0	0	0	0	0

a. Excludes allowance for pay raises in 1990 through 1993.

Proposed Policy Changes

The allowances function contains an initiative by the Administration to raise the applicable minimum contract size covered under the Davis-Bacon Act and the Service Contract Act to $100,000 for all federal agencies except the Department of Defense (DoD). (The proposal to raise the threshold for DoD contracts is contained in function 050.) Both acts currently require that prevailing local wages be paid to workers hired by contractors involved in all federally funded or assisted projects above certain thresholds--$2,000 for Davis-Bacon and $2,500 for Service Contract. Increasing the minimum contract size for non-DoD agencies to $100,000 would allow contractors on smaller projects to pay lower wages in some cases. The Administration's budget assumes a reduction of $50 million in annual budget authority, resulting in outlay reductions of $48 million in 1989 and $247 million over the 1989-1993 period.

CBO Reestimates

There are no reestimates in this function. For discretionary funding programs, CBO assumes the budget request. CBO estimates, however, that the proposed changes in the two acts would reduce needed funding by $41 million annually, saving $167 million in outlays over the next five years.

FUNCTION 950: UNDISTRIBUTED OFFSETTING RECEIPTS

PROPOSED MAJOR SPENDING CHANGES

(By fiscal year, outlays in billions of dollars)

Item	1989	1990	1991	1992	1993	Cumulative Five-Year Changes
CBO Baseline	-37.9	-39.4	-41.3	-43.2	-45.2	
Proposed Changes						
Employer share, employee retirement	0.3	-0.6	-0.9	-1.4	-1.9	-4.5
Sale of the naval petroleum reserves a/	-2.5	-0.8	0	0	0	-3.3
Sale of power marketing administrations a/	-0.1	-1.4	0	0	0	-1.5
Spectrum fees	0	-0.3	-0.3	-0.3	-0.3	-1.0
Total	-2.3	-3.1	-1.2	-1.6	-2.2	-10.3
President's 1989 Budget as Estimated by CBO	-40.2	-42.5	-42.5	-44.8	-47.3	
President's 1989 Budget	-41.0	-42.2	-42.7	-45.3	-47.7	
CBO Reestimates	0.8	-0.3	0.2	0.5	0.3	1.6

a. The receipts from the proposed sale of the naval petroleum reserves and the Alaska and Southeastern power marketing administrations shown here would increase outlays in function 270, relative to the baseline, because these assets would no longer generate receipts for the government.

Proposed Policy Changes

The budget includes new measures for increasing undistributed offsetting receipts by about $10 billion over the 1989-1993 period. The President is proposing changes that would increase certain agency contributions for employee retirement. He is also proposing to sell the government's interests in the naval petroleum reserves (NPRs) and in two of the five power marketing administrations (PMAs)--the Alaska and Southeastern PMAs. CBO estimates that these asset sales, if carried out, could bring in about $4.8 billion in receipts to the government by 1993, though lost income that would have been generated by the NPRs and the Alaska and Southeastern PMAs would total $2.9 billion over the 1989-1993 period. The President also proposes to collect fees for the rights to use communications frequencies.

Employer's Share of Employee Retirement. Agency contributions to employee retirement programs are intragovernmental payments that are paid out of the individual program accounts and recorded as offsetting receipts in function 950. The President proposes to increase U.S. Postal Service payments for employee retirement beginning in 1990. The President's pay raise proposals would decrease agency payments in 1989 and 1990, but increase payments after 1990 relative to the CBO baseline.

The President would require the U.S. Postal Service to make additional payments to the Civil Service Retirement Trust Fund to pay for postal retirees' cost-of-living adjustments (COLAs). The 1990 payment would cover the cost of both the 1989 and 1990 COLAs for postal retirees. This proposal would increase agency payments by a total of $3.6 billion over the 1990-1993 period, largely derived from increased postal rates that would be necessitated by this proposal.

The President requests higher military pay raises than were included in the CBO baseline, but delays their payment for three months. The President also proposes lower civilian pay raises and delays payment until January of each year. Taken together, these pay proposals would reduce the employer share of employee retirement by $0.3 billion in 1989, but would increase such agency contributions by about $0.9 billion over the 1989-1993 period.

Naval Petroleum Reserves. The government owns approximately 78 percent of the Elk Hills oil field, known as NPR-1, and 100 percent of the much smaller Teapot Dome oil field, known as NPR-3. Selling these interests would raise federal receipts by an estimated $3.3 billion by 1990. The selling price depends to a great extent on the timing of these sales and the private market's expectations of future oil prices. Selling the reserves would reduce net income from oil sales by about $2.5 billion from 1990 through 1993 and by additional amounts thereafter.

Power Marketing Administrations. The President recommends selling two of the five PMAs in the Department of Energy: the Alaska

PMA and the Southeastern PMA. These agencies sell and transmit the electricity produced at federal dams. CBO estimates that the government could receive about $1.5 billion from sales of these two PMAs by the end of 1990, which would be partially offset by lost income (in the energy function) of approximately $0.4 billion over the 1990-1993 period and additional amounts in subsequent years.

Both CBO and the Administration estimate sales receipts of $100 million for the Alaska PMA and $1.4 billion for the Southeastern PMA. Potential receipts from selling the two PMAs are very uncertain, because of the differing values of these assets to prospective buyers, and because of the uncertain impact of the sale on federal tax revenues.

Spectrum Fees. The President proposes to charge a fee for the right to transmit and receive information over the radio frequency spectrum. No charge would be applied to mass media, public safety, or amateur services. The budget does not provide details of the proposal for spectrum fees, but the Administration estimates that it would gen-erate additional annual receipts of $250 million beginning in 1990.

CBO Reestimates

The President's budget projects receipts from the Outer Continental Shelf (OCS) that are $1.8 billion greater through 1993 than those estimated by CBO. The budget assumes that the Supreme Court will rule in favor of the federal government in a dispute with Alaska over OCS receipts held in escrow; it also assumes higher levels of production and prices for oil and gas. CBO assumes that the OCS receipts in escrow would be split evenly between Alaska and the federal government.

The budget includes receipts from the sale of the NPRs of $3.2 billion in 1989 and $0.3 billion in 1990, for a total of $3.5 billion. CBO estimates receipts of $2.5 billion in 1989 and $0.8 billion in 1990, for a total sale amount of $3.3 billion. CBO assumes that 75 percent of the sale receipts would be obtained in 1989; the budget assumes that over 90 percent of the receipts would occur in 1989. The reestimate of sales receipts for the NPRs assumes lower oil prices than the budget.

APPENDIXES

APPENDIX A

BASELINE BUDGET PROJECTIONS

Baseline budget projections show the levels of revenues, outlays, and deficits that are expected to result during the next five years if current budgetary policies remain unchanged. They provide a useful starting point for analyzing the changes in national priorities recommended by the President and their dollar effect on budget totals. Throughout this volume, revenue changes and spending recommendations in the President's budget are compared with CBO's baseline projections.

Table A-1 summarizes the CBO baseline projections of revenues, outlays, deficits, and debt. The budget estimates are consistent with the economic assumptions described in Chapter II. For revenues and for entitlement programs such as Social Security, the baseline is projected according to current laws. Many other federal government programs--including defense programs and many nondefense activities such as space, transportation, and health research--are funded annually in appropriation acts. For these activities, the baseline assumes that future appropriations are adjusted to reflect inflation. Estimates of offsetting receipts are consistent with current laws and policies, and net interest projections reflect the assumed interest rates and deficits.

The federal government's deficit in 1987 was $150 billion, but as Table A-1 shows, the deficit is expected to increase in both 1988 and 1989 unless there are further changes in budgetary policies. The deficit declines slowly after 1989, reaching $139 billion in 1993. To a large extent, these year-to-year fluctuations reflect the transitional effects of the Tax Reform Act of 1986, as well as various one-time outlay savings (such as asset sales) enacted in recent years. CBO's earlier report, *The Economic and Budget Outlook: Fiscal Years 1989-1993*, described in detail the dynamics of revenues and spending under current budgetary policies.

During the past month, CBO has revised its baseline budget projections to reflect additional information, much of which became

TABLE A-1. CBO BASELINE BUDGET PROJECTIONS (By fiscal year)

	1988	1989	1990	1991	1992	1993
	In Billions of Dollars					
Revenues						
Individual income	390	415	455	495	533	575
Corporate income	99	107	119	126	130	134
Social insurance	331	352	381	408	433	465
Other	79	80	82	83	84	87
Total	898	954	1,036	1,111	1,181	1,261
Outlays						
National defense	287	295	306	320	333	346
Nondefense discretionary spending	176	193	203	207	215	222
Entitlements and other mandatory spending	500	536	573	610	650	694
Net interest	152	166	185	198	203	208
Offsetting receipts	-56	-59	-61	-64	-67	-70
Total	1,059	1,131	1,206	1,271	1,335	1,400
Deficit	161	177	170	159	154	139
Debt Held by the Public	2,046	2,222	2,391	2,547	2,700	2,838
	As a Percent of GNP					
Revenues						
Individual income	8.3	8.3	8.5	8.7	8.8	8.8
Corporate income	2.1	2.1	2.2	2.2	2.1	2.1
Social insurance	7.1	7.1	7.1	7.2	7.1	7.2
Other	1.7	1.6	1.5	1.5	1.4	1.3
Total	19.2	19.1	19.5	19.5	19.4	19.4
Outlays						
National defense	6.1	5.9	5.7	5.6	5.5	5.3
Nondefense discretionary spending	3.8	3.9	3.8	3.6	3.5	3.4
Entitlements and other mandatory spending	10.7	10.7	10.8	10.7	10.7	10.7
Net interest	3.2	3.3	3.5	3.5	3.3	3.2
Offsetting receipts	-1.2	-1.2	-1.2	-1.1	-1.1	-1.1
Total	22.6	22.7	22.6	22.3	22.0	21.5
Deficit	3.4	3.6	3.2	2.8	2.5	2.1
Debt Held by the Public	43.7	44.6	44.9	44.8	44.4	43.7

SOURCE: Congressional Budget Office.
NOTE: Totals include Social Security, which is off-budget.

available with the release of the Administration's budget. In the aggregate, these revisions are small, adding to the deficit by an average of $3 billion a year. Table A-2 summarizes the changes to CBO's earlier projections.

The major change in revenue projections stems from assumptions about airport and airways taxes and affects fiscal years after 1989. As noted in Chapter III, legislation enacted last year provided that most

TABLE A-2. REVISIONS TO THE CBO BASELINE SINCE FEBRUARY 1988
(By fiscal year, in billions of dollars)

	1988	1989	1990	1991	1992	1993
Revenues						
Original Baseline	897	953	1,036	1,112	1,181	1,262
Changes						
Airport and airway taxes	--	--	-1	-2	-2	-2
Other	1	1	1	1	1	1
Total	1	1	a/	-1	-1	-1
Revised Baseline	898	954	1,036	1,111	1,181	1,261
Outlays						
Original Baseline	1,055	1,129	1,203	1,269	1,332	1,396
Changes						
Deposit insurance	4	2	a/	a/	a/	--
Other	1	a/	2	1	3	4
Total	5	2	3	1	2	4
Revised Baseline	1,059	1,131	1,206	1,271	1,335	1,400
Deficit						
Original Baseline	157	176	167	158	151	134
Changes	4	1	2	2	3	5
Revised Baseline	161	177	170	159	154	139

SOURCE: Congressional Budget Office.

a. Less than $500 million.

aviation tax rates will be halved on January 1, 1990, if airport and airway spending fails to reach certain thresholds. CBO's earlier estimates assumed extension of all trust fund taxes at current rates. This change makes the baseline projections consistent with the President's budget and lowers revenues by $1 billion to $2 billion a year after 1989. Other revenue revisions are small, raising revenues by about $1 billion a year. The near-term revisions to outlays stem largely from an accounting change. In its 1989 budget, the Administration counts as outlays certain promissory notes issued by the Federal Deposit Insurance Corporation (FDIC) and the Federal Savings and Loan Insurance Corporation (FSLIC). This change mirrors the budgetary treatment of FDIC demand notes, which have been counted in budget outlays since the 1988 budget. The change raises outlays by $4 billion in 1988 and $2 billion in 1989. Other revisions affect a wide variety of spending programs and are small in the aggregate.

APPENDIX B

MAJOR CONTRIBUTORS TO THE REVENUE AND SPENDING ESTIMATES

The following analysts prepared the revenue and spending estimates in this report:

Revenue Estimates

Mark Booth	Corporate income taxes, Federal Reserve System earnings
Jon Hakken	Windfall profit tax
Richard Kasten	Individual income taxes
Jeffrey Miller	Excise taxes
Kathleen O'Connell	Individual income taxes, estate and gift taxes
Marianne Page	Customs duties, miscellaneous receipts
Linda Radey	Social insurance contributions, excise taxes
Frank Sammartino	Individual income taxes

Spending Estimates

Defense and International Affairs

Eugene Bryton	Defense
Kent Christensen	International affairs
Ray Hall	Defense
Barbara Hollinshead	Defense
William Myers	Defense
Amy Plapp	Defense
Joseph Whitehill	International affairs
Ben Wolters	Defense

Spending Estimates (continued)

Human Resources

Paul Cullinan	Social Security
Richard Curley	Supplemental Security Income, veterans' education
Carmela Dyer	Public Health Service, federal retirement
Alan Fairbank	Hospital Insurance
Holly Harvey	Supplementary Medical Insurance
Deborah Kalcevic	Education
Jean Kayser	Health programs
Julia Isaacs	Food Stamps, child nutrition
Donald Muse	Medicaid, Medicare
Michael Namian	Social services
Janice Peskin	Aid to Families with Dependent Children, child support enforcement
Michael Pogue	Unemployment Insurance, training programs
Kathleen Shepherd	Veterans' benefits

Natural and Physical Resources

Kim Cawley	Energy
Carol Cohen	Community and regional development
Douglas Criscitello	Commerce, disaster relief and insurance
Peter Fontaine	Energy, Farm Credit System
Theresa Gullo	Water resources, conservation, and land management
James Hearn	General government, Agricultural Credit Insurance Fund, Outer Continental Shelf receipts
Hsin-Hui Hsu	Agriculture
Mary Maginniss	Postal Service, deposit insurance, Small Business Administration
Eileen Manfredi	Agriculture

Spending Estimates (continued)

Natural and Physical Resources (continued)

Marjorie Miller	Transportation, Federal Housing Administration
Andrew Morton	Agriculture
Deborah Reis	Recreation, pollution control, water transportation
Mitchell Rosenfeld	Air transportation, justice
Brent Shipp	Housing and mortgage credit
Michael Sieverts	Science and space, justice, other natural resources

Other

Janet Airis	Appropriation bills
Edward Blau	Appropriation bills
Paul Christy	Other interest
David Elkes	National Income and Product Accounts
Betty Embrey	Appropriation bills
Kenneth Farris	Computer support
Danila Girerd	Credit analysis
Glen Goodnow	Authorization bills
Vernon Hammett	Computer support
Sandra Hoffman	Computer support
Richard Krop	Civilian agency pay
Fritz Maier	Computer support
Roy Meyers	Budget process
Kathy Ruffing	Treasury borrowing, interest, and debt
Robert Sempsey	Appropriation bills
Robert Seiler	Budget process
Jeff Swersey	Computer support
Karla Trujillo	Appropriation bills
Paula Williams	Computer support

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